IX. Busted Deals: Stable v. Maps Hotels and COVID-19's Effect on Contracting for Mergers and Acquisitions

B. Introduction

From late 2019 to early 2020, the COVID-19 pandemic spread worldwide prompting a once-in-a-century public health crisis with vast politico-economic consequences. The travel and hospitality industry, facing a drop-off in demand, fared particularly poorly in the initial months of the pandemic.[1] As various industries shut down in early 2020, average deal value and volume declined accordingly in the M&A space.[2] But what of the deals negotiated before the onset of COVID-19 that had yet to close? Several prospective acquirers attempted to terminate pending tender offers or otherwise withdraw from deals.[3] The most prominent of these "busted deals" was the $15.8 billion acquisition of Tiffany & Co. by French luxury conglomerate LVMH.[4] Like many buyers, in response to a lawsuit filed by Tiffany, LVMH cited the existence of a material adverse effect and breach of ordinary course covenants to justify their purported termination of the

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[1] ACCENTURE, COVID-19: REBALANCE FOR RESILIENCE WITH M&A 5 (2020) (calculating a market capitalization loss in the travel and hospitality industry of 49% from February 21 to March 16, 2020).

[2] *Id.* at 3 ("[D]eal value and volume contracted rapidly in the wake of COVID-19. Deal volume in the first half of 2020 dropped 49%[.]").

[3] Richard D. Harroch et al., *The Impact of the Coronavirus Crisis on Mergers and Acquisitions*, FORBES (Apr. 17, 2020, 6:00 AM), https://www.forbes.com/sites/allbusiness/2020/04/17/impact-of-coronavirus-crisis-on-mergers-and-acquisitions/?sh=521e0a06200a ("Parties to pending M&A transactions are also abandoning significant deals that were pending, such as Xerox recently dropping its $34 billion offer for HP[.] SoftBank has terminated its $3 billion tender offer for WeWork shares, citing the coronavirus impact together with the failure of a number of closing conditions. Bed Bath & Beyond has initiated litigation in Delaware with respect to delays in the pending sale of one of its divisions to 1-800-Flowers for $250 million. Boeing suppliers Hexcel and Woodward have called off their pending $6.4 billion merger of equals transaction noting the 'unprecedented challenges' caused by the pandemic.").

[4] Pamela N. Danziger, *What's Ahead for Tiffany Once LVMH Takes Over?* FORBES (Nov. 15, 2020, 5:00 AM), https://www.forbes.com/sites/pam-danziger/2020/11/15/whats-ahead-for-tiffany-once-lvmh-takes-over/?sh=633c1ce63c90 (summarizing the LVMH-Tiffany litigation and public "mud-slinging" surrounding it).

deal.[5] The LVMH-Tiffany litigation ultimately settled and resulted in the consummation of the merger, but in November 2020, the Delaware Chancery Court in *AB Stable VIII LLC v. Maps Hotels and Resorts One LLC et al.*, ruled that the prospective buyer could terminate a September 2019 Sale Agreement as the seller did not comply with its ordinary course covenant due to changes brought on by the pandemic.[6]

This article will summarize and analyze the *Stable* decision with a particular focus on the Delaware Chancery Court's conclusions that the pandemic did not implicate the material adverse effect provision of the Sale Agreement, while changes to the business of the target company breached the ordinary course covenant. Part B will summarize and comment on the particulars of the decision itself. Part C will comment on the ramifications of the decision, suggesting that while the decision may lead to more explicit invocations of pandemics in Sale Agreements, the decision's ramifications are likely narrow.

C. The Chancery Court's Decision

1. The Deal, the September 2019 Sale Agreement, and the Relevant Provisions

On September 10, 2019, AB Stable VIII LLC (Seller), a subsidiary of Dajia Insurance Group, a Chinese corporation, contracted to sell its interests in Strategic Hotels & Resorts LLC (Strategic) to MAPS Hotels and Resorts One LLC (Buyer), an entity owned by Mirae Asset Financial Group, a Korean financial services conglo-

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[5] *See* Harroch et al., *supra* note 3 (discussing the use of material adverse effect provisions and ordinary course covenants in mergers and acquisitions); Press Release, LVMH, LVMH files countersuit against Tiffany (Sept. 29, 2020) https://r.lvmh-static.com/uploads/2020/09/lvmh-countersuit-press-release-29-sept-2020.pdf (announcing LVMH's countersuit against Tiffany arguing that "the conditions necessary to close the acquisition of Tiffany have not been met").

[6] Press Release, LVMH, LVMH completes the acquisition of Tiffany & Co. (Jan. 7, 2021) https://r.lvmh-static.com/uploads/2021/01/lvmh-press-release-7-jan-2021.pdf ("LVMH … has completed the acquisition of Tiffany & Co."); *see also* AB Stable VII LLC v. Maps Hotels and Resorts One LLC et al, C.A. No. 2020-0310-JTL, 2020 WL 7024929, at *2 (Del. Ch. Nov. 30, 2020) ("Buyer proved that due to the COVID-19 pandemic, [target] Strategic made extensive changes to its business. Because of those changes, its business was not conducted … in the ordinary course[.]").

merate, for $5.8 billion.[7] Strategic was a Delaware LLC which owned fifteen luxury hotels.[8] The scheduled closing date of the deal was April 17, 2020, but when that date arrived, the Buyer contended that it was not obliged to close because the Seller had breached the terms of the Sale Agreement and threatened termination if the Seller did not cure the breach by May 2, 2020.[9] Among those breaches, *inter alia*, the Buyer contended that the Seller had breached the Sale Agreement's Bring Down and Covenant Compliance Conditions.[10]

The Bring Down Condition gave the Buyer the right to withhold on closing the deal if the Seller made inaccurate representations "sufficient to result in a contractually defined Material Adverse Effect."[11] The Buyer contended that Seller's representations from July 31, 2019, that "there had not been any changes, events, states of facts, or developments, whether or not in the ordinary course of business that, individually or in the aggregate, have had or would reasonably be expected to have a Material Adverse Effect (the "No-MAE Representation")" were inaccurate due to material adverse effects suffered by the Seller due to the onset of the pandemic.[12]

Material adverse effect (MAE) provisions are meant to address changes in value to target companies that occur between signing and closing a deal, usually allowing a buyer to terminate the deal if such a "materially adverse" change occurs.[13] However, parties in merger transactions rarely define "materiality" or "adverseness" in their agreements, instead "negotiat[ing] for exceptions and exclusions from exceptions" to the definition of what constitutes a MAE.[14] As a result, MAE provisions allocate general and systemic risks to the

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[7] *Stable*, 2020 WL 7024929, at *1 (setting forth the parties to the transaction at issue).

[8] *Id.*

[9] *Id*. ("Buyer informed Seller that if the breaches were not cured on or before May 2, 2020, then Buyer would be entitled to terminate the Sale Agreement.").

[10] *Id.* at *1–2 (summarizing the allegations of the Buyer with regard to the Bring Down Condition and the Covenant Compliance Condition).

[11] *Id*. at *1.

[12] *Id.* at *1–2.

[13] *Id*., at *74 ("Conditioning the buyer's obligation to close on the absence of a material adverse effect addresses the risk of a significant deterioration in the value of the seller's business between signing and closing that threatens the fundamentals of the deal.").

[14] Akorn, Inc. v. Fresenius Kabi AG, C.A. No. 2018-0300-JTL, 2018 WL 4719347, at *49 (Del. Ch. Oct. 1, 2018).

seller, and through exceptions, specific risks to the buyer, and other specific risks to the seller through the exclusions to exceptions.[15] In *Stable*, the Buyer contended that the contractually-agreed upon definition of MAE was met by the COVID-19 pandemic, and that there was no relevant exception that allocated the risk of a pandemic to the Buyer.[16] This meant that the Seller's No-MAE Representation was inaccurate, which in turn triggered the Bring Down Condition, relieving the Buyer's obligation to close the deal.[17]

The Covenant Compliance Condition relieved the obligation of the Buyer to close the deal if the Seller failed to comply with various covenants between signing and closing.[18] The Buyer contended that, because the Seller had failed to comply with its ordinary course covenant, the Buyer was not obligated to close.[19] In contrast to MAE provisions, ordinary course covenants (OCCs) "recognize[] that the buyer has contracted to buy a specific business with particular attributes that operates in an established way."[20] Thus, while MAE provisions are concerned with the value of the deal, OCC provisions are concerned with the substantive business practices of the target company.[21] In *Stable*, the OCC provision guaranteed that the Seller's business would "be conducted only in the ordinary course of business consistent with past practice in all material respects."[22] The Buyer argued that because Strategic substantially altered its business

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[15] *Id.* ("[T]he MAE provision … plac[es] the general risk of an MAE on the seller, then using exceptions to reallocate specific categories of risk to the buyer. Exclusions from the exceptions therefore return risks to the seller.").

[16] *Stable*, 2020 WL 7024929, at *1–2 ("According to Buyer, the business of Strategic and its subsidiaries suffered a Material Adverse Effect due to the onset of the COVID-19 pandemic, rendering the No- MAE Representation inaccurate, causing the Bring-Down Condition to fail, and relieving Buyer of its obligation to close.").

[17] *Id.*

[18] *Id.* at *2 ("Buyer was not obligated to close if Seller failed to comply with its covenants between signing and closing.").

[19] *Id.* ("Because of [COVID-19, Strategic's] business was not conducted only in the ordinary course of business, consistent with past practice in all material respects … relieving Buyer of its obligation to close.").

[20] *Id.* at *74.

[21] *Id.* ("The [MAE] provision … protects the buyer against a significant decline in valuation …. The ordinary course covenant … is primarily concerned with a change in how the business operates, irrespective of any change in valuation.").

[22] *Id.* at *48.

practices in response to COVID-19, the Seller violated the OCC, relieving the Buyer of its obligation to close.[23]

2. MAEs and 'Natural Disasters or Calamities'

The Chancery Court in *Stable* did not analyze whether the effects of the pandemic were sufficiently "material" or "adverse," instead finding that pandemics like COVID-19 fit neatly into the Sale Agreement's exception for "natural disasters or calamities[.]"[24] Accordingly, the court proceeded with its analysis as if the pandemic was sufficiently material and adverse to rise to the level of a MAE as defined by the agreement.[25] Although the court confined its holding to the "natural disasters or calamities" exception, it noted that there were several potentially relevant exceptions to the MAE definition such as "changes in … political conditions … or market conditions[.]"[26] However, the Buyer argued that the condition causing the MAE may only be excused by an exception to the definition of a MAE if the condition itself is the "root cause" of the MAE.[27] The Buyer contended that the pandemic was not a "natural disaster or calamity," but conceded that if it was, the pandemic would be the "root cause" of the MAE such that the exception would apply.[28] Although the court disagreed with the Buyer's "root cause" interpretation based on "the plain language of the MAE Definition[,]" the court decided the MAE claim relying on the "natural disasters or calamities" exception.[29]

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[23] *Id*. at *64 ("Buyer argues that the Covenant Compliance Condition failed because Seller did not comply with the Ordinary Course Covenant.").

[24] *Id.* at *55 (explaining that although the court would ordinarily determine whether "Strategic suffered an effect that was sufficiently material and adverse to meet the strictures of Delaware case law[,]" in a case when the issue falls within a carve out to the definition of a MAE it is not necessary to analyze the substance).

[25] *Id.* ("This decision assumes for the purposes of analysis that Strategic suffered an effect due to the COVID-19 pandemic that was sufficiently material and adverse to satisfy the requirements of Delaware case law.").

[26] *Id.*

[27] *Id.* ("According to Buyer, the court must determine the root cause of the MAE. Buyer argues that if an exception does not explicitly refer to the root cause, then it is not implicated.").

[28] *Id.* at *57 ("Buyer maintains that the COVID-19 pandemic is not a natural disaster or calamity, but Buyer agrees that if it were, then the exception would apply.").

[29] *Id.*

Analyzing the plain language of the Sale Agreement, the court found that the COVID-19 pandemic was encompassed by the "natural disasters or calamities" exception.[30] The Buyer argued that although the word "calamities" is sufficiently broad to include the pandemic, under the doctrine of *noscitur a sociis*, the court should limit its reading of "calamities" to phenomena similar to natural disasters.[31] The court dismissed the Buyer's interpretation argument as moot, finding that COVID-19 clearly fit within the definition of "natural disasters," as it was "a terrible event that emerged naturally in December 2019, grew exponentially, and resulted in serious economic damage and many deaths."[32]

Notably, the court also considered "Deal Studies" provided by the parties in defining "natural disasters or calamities." Each party put forth evidence from expert witnesses who analyzed 144 publicly available high-priced deals from the year before the Sale Agreement.[33] The Buyer's expert witness, Professor John Coates of Harvard Law School, noted that pandemics were explicitly contemplated in MAE definitions separately from natural disasters and calamites in a substantial number of the analyzed agreements.[34] Therefore, the Buyer contended, the omission of an express reference to pandemics in the Sale Agreement proved that there was no intent to carve pandemics out of the definition of MAE.[35] However, the court held that the inconsistency of the MAE definitions from the sample showed that "general terms like 'calamity,' [or] 'natural disaster,' … can encompass pandemic risk because a meaningful number of agreements make explicit connections among these terms."[36] Therefore, because natural disasters were excepted from the definition of MAE, the Seller's No-

[30] *Id.* at *65 ("[T]he COVID-19 pandemic … falls within an exception to the MAE Definition for effects resulting from 'calamities.'").
[31] *Id.* at *58 ("Buyer asserts that because the word 'calamity' appears in the phrase 'natural disasters or calamities,' it must be read as referring to phenomena that have features similar to natural disasters.").
[32] *Id.*
[33] *Id.* at *63 (describing the deal studies prepared by the litigants).
[34] *Id.* at *64 ("A large minority [of deals] (33%) specifically excluded one or more of pandemics, epidemics, public health crises, or influenzas.").
[35] *Id.*, at *63 ("According to Buyer, the failure to include the term 'pandemic' must have been intentional, and its omission therefore should be dispositive.").
[36] *Id.* at *64.

MAE Representation was not inaccurate, and the Bring Down Condition did not fail.[37]

3. OCCs and "Past Practice"

In *Stable*, the court found that Strategic was not operating in the ordinary course due to the changes it had made in response to the COVID-19 pandemic, allowing the Buyer to terminate the Sale Agreement. The Chancery Court's analysis of the OCC emphasized the plain meaning of the text of the provision, with the parties differing in their interpretation of various components thereof. The Seller contended that, as a parent to several hotels, Strategic was an asset manager and not in the hospitality business.[38] Thus, the Seller argued, the "business" in question, as applied to the OCC, was Strategic's business as an asset manager, which had largely continued as before COVID-19, not the hotels' operations, which had changed drastically.[39] The court rejected the Seller's arguments, finding that the plain language of the OCC provided that "'the business *of the Company and its Subsidiaries* shall be operated in the ordinary course[,]'" which was sufficiently broad to cover the operations of the hotels, subsidiaries of Strategic.[40]

The Seller also argued that Strategic *had* operated its business in the ordinary course—as compared to other hotels dealing with a pandemic.[41] In assessing what the standard is for "the ordinary course of business," courts can look to either a company's past operations or to the operations of similar companies under comparable circumstances.[42] In *Stable*, the Seller advocated for the latter interpretation.[43]

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[37] *Id.* at *65 ("The Bring-Down Condition did not fail due to the No-MAE Representation becoming inaccurate.").

[38] *Id.* ("Seller frames Strategic's business at a high level and claims that it primarily involves deploying capital and overseeing the Hotels' managers, reducing Strategic's role to a supervisory manager of managers.").

[39] *Id.* ("According to Seller, the COVID-19 pandemic did not result in any changes to … high-level tasks which Strategic continued performing as the pandemic raged and as the hotels radically changed their operations.").

[40] *Id.* at *66 ("[The OCC] encompasses the business of each of the 'Subsidiaries,' necessarily including the entities that ow the Hotels.").

[41] *Id.* at *67 ("Seller responds that management must be afforded flexibility to address changing circumstances and unforeseen events, including by engaging in 'ordinary responses to extraordinary events.'").

[42] *Id.* at *70 ("First, the court can look to how the company has operated in the past, both generally and under similar circumstances. Second, the court can

However, the Chancery Court rejected the Seller's argument, relying on its holding in *Akorn, Inc. v. Fresenius Kabi AG*. In *Akorn*, the court compared the seller's actions to "a generic pharmaceutical company operating in the ordinary course of business" despite the fact that the OCC in that case did *not* limit the ordinary course of business to conduct "only … consistent with past practice."[44] Given that the *Akorn* court compared the seller's conduct with a generic company without particular regard to the quirks and idiosyncrasies of the seller's circumstances, and in the absence of limiting language in the *Akorn* OCC, the *Stable* court reasoned that the presence of that limiting language in the *Stable* OCC demanded the court look "exclusively" to the past practice of Strategic as a standard of conduct.[45] Therefore, as compared to *Strategic's* past business practices, the changes made in response to COVID-19 represented a deviation from the ordinary course.

The Seller also argued, albeit briefly, that because the Seller was obligated by law to deviate from the ordinary course of business, those deviations could not have breached the OCC.[46] The Seller made representations that Strategic's operations complied with applicable local public health law which precluded its ability to operate its business in the normal course.[47] If the Seller had not complied with applicable law, it argued, the Bring Down Condition would have been triggered, relieving the Buyer of its obligation to close.[48] The court ultimately rejected this argument for lack of evidence, finding that even assuming the Seller's argument was legally correct, "[t]here are … substantial questions about whether Strategic was legally obligated to make changes to its business."[49] However, the court conceded that had the issue been properly briefed, there would not be a clear answer

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look to how comparable companies are operating or have operated, both generally and under similar circumstances.").

[43] *Id*. (stating the seller's position).

[44] *Id*. (citing *Akorn*, 2018 WL 4719347, at *88).

[45] *Id*. at *71 ("By including the adverb 'only' and the phrase 'consistent with past practice,' the parties created a standard that looks exclusively to how the business has operated in the past.").

[46] *Id*. at *78 ("Seller seemed to suggest that if it had to deviate from the ordinary course of business to comply with the law … then it did not breach the Ordinary Course Covenant by doing so.").

[47] *Id*.

[48] *Id.* at *80 (summarizing Seller's argument that noncompliance with local law would trigger the Bring Down Condition).

[49] *Id*. at *81.

as to whether a government order could excuse the deviation from the ordinary course of business. The Seller might have argued as a matter of public policy that the deviation was excused by fact of the government order, and the Buyer that the terms of the Covenant Compliance Condition turn on material compliance with "all covenants and conditions required by [the] Agreement."[50] Thus, questions remain as to whether government-mandated deviations from an OCC will breach that covenant.

D. Applicability of *Stable* and Possible Future Effects

Although the decision allowing the Buyer to terminate the deal in *Stable* may seem drastic at first blush, the court narrowly focused on the plain language of the Sale Agreement and the evidence of changes made to Strategic's business. In its pre-closing countersuit against Tiffany, LVMH made the same arguments with regard to MAE and OCC provisions as the Buyer in *Stable* did, but it is unlikely that those claims would have borne any fruit in the LVMH-Tiffany context.[51] This is because the effect of COVID-19 on the travel and hospitality industry was uniquely negative: the travel and hospitality industry lost 49% of its market capitalization in the first 25 days of the COVID-19 crisis in February and March 2020 compared to the retail industry's substantial, but far less significant, loss of 19%.[52] Had the LVMH suit proceeded to trial, the court likely would have placed the pandemic into the "natural disasters or calamities" bucket as it did in *Stable*, finding that pandemics were excepted from the definition of MAE.[53] However, the pandemic drastically altered the business model of Strategic, causing the hotels to offer far fewer services to far fewer travelers.[54] While the pandemic probably affected Tiffany's business substantially from the perspective of reduced *value*, those effects are

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[50] *Id*. at *80.

[51] Press Release, LVMH files countersuit against Tiffany, *supra* note 5 (announcing LVMH's counterclaims against Tiffany in their 2020 litigation, alleging the occurrence of an MAE and a breach of the OCC).

[52] ACCENTURE, *supra* note 1, at 5 (presenting the data on the losses suffered by various industries during the first 25 days of the COVID-19 pandemic).

[53] *Stable*, 2020 WL 7024929, at *63 (discussing whether the pandemic fit into "natural disasters or calamities").

[54] *Id*. at *75 (summarizing all the changes Strategic made in response to the COVID-19 pandemic).

not meant to be addressed by an OCC.[55] Rather, OCCs are merely meant to ensure that the target business's substantive operations are substantially the same as when the parties signed the Sale Agreement, and Tiffany probably did not make changes on the level of those made by Strategic sufficient to breach an OCC.[56]

However, *Stable* is a notable decision in that the court's commitment to the legal primacy of the plain language of the Sale Agreement led to a somewhat irrational outcome. Had the Seller complied with the OCC and continued to operate its hotels as if no pandemic existed, it might have done irreparable financial harm to Strategic.[57] Ironically, the Seller's action in altering its business was for the *Buyer's* benefit. How, then, is a seller meant to operate in good faith if, under a literal reading of the sale agreement, no good deed goes unpunished? The most obvious way for sellers to address this problem is that if they are worried about circumstances like the COVID-19 pandemic, they should bargain for more flexible language in OCC provisions that do not bind them to operate "consistent with *past practice*" when extenuating circumstances arise.[58] Had the *Stable*

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[55] *Id*. at *74 ("The [MAE] provision ... protects the buyer against a significant decline in valuation …. The ordinary course covenant … is primarily concerned with a change in how the business operates, irrespective of any change in valuation.").

[56] *Id.* (discussing the main purpose of an ordinary course covenant).

[57] Andrew J. Noreuil et al., *Ordinary Course of Business in the Shadow of the Pandemic: Delaware Court Rules That Measures Resulted in Breach of Covenant*, MAYER BROWN (Dec. 15, 2020), https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2020/12/ordinary-course-of-business-in-the-shadow-of-the-pandemic.pdf ("Another key takeaway from the court's decision is its position that Seller should have continued to operate Strategic's business in the same manner it had historically, inflicting greater financial damage on the business than operating the business with the changes that Seller implemented.").

[58] Angelo Bovino et al., *Delaware Court of Chancery Permits Buyer to Terminate Merger Due to Target's Failure to Operate in the Ordinary Course; But Finds No MAE Due to COVID-19*, PAUL WEISS (Dec. 7, 2020), https://www.paulweiss.com/practices/transactional/mergers-acquisitions/publications/delaware-court-of-chancery-permits-buyer-to-terminate-merger-due-to-target-s-failure-to-operate-in-the-ordinary-course-but-finds-no-mae-due-to-covid-19?id=38871 ("Parties should consider whether extraordinary, pandemic-related actions are "ordinary course" and draft their agreements accordingly. For example, in view of this uncertainty, sellers may want to add language clarifying that "ordinary course" includes actions during the pan-

court compared Strategic's changed operations to those of a generic hotel business reacting to a global pandemic, it may well have found that the Seller's alterations were within the ordinary course. Additionally, contrary to what the Seller did in *Stable*, sellers would be well-advised to "seek permission and not forgiveness" and obtain the buyer's consent before taking extraordinary measures due to externally caused crises.[59] This would have the effect of shifting the legal burdens to the Buyer, who, if withholding consent, would have the burden to "prove that its refusal to grant consent was not unreasonable."[60]

E. Conclusion

The onset of the COVID-19 pandemic caused unpredictable changes for dealmakers, sometimes resulting in fraught litigation. In the case of *Stable*, that litigation did not ultimately result in game-changing alterations to precedent with regard to MAE and OCC provisions. However, the outcome of that case is illustrative: contract drafters face great difficulty in trying to predict the unpredictable, and the rough justice faced by the Seller in *Stable* is reason enough to anticipate disciplined adherence from judicial authorities to the formal language of Sale Agreements even when uniquely catastrophic conditions arise.

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demic or other industry practices in responding to material events or changes in circumstances.").

[59] Barbara Borden et al., *Delaware Puts the Conduct of Business Covenant on Center Stage in COVID-Related M&A Dispute*, COOLEY (Dec. 15, 2020), https://cooleyma.com/2020/12/15/delaware-puts-the-conduct-of-business-covenant-on-center-stage-in-covid-related-ma-dispute/ ("[W]here seller believed that its actions were necessary to preserve its business in light of extraordinary circumstances outside its control and buyer's consent could not be unreasonably withheld, it would behoove sellers to seek buyer's permission prior to taking any actions outside the ordinary course, thereby putting the burden on buyer to prove that it acted reasonably in withholding its consent.").

[60] *Id.*

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