Pre-COVID Deals, Post-COVID Litigation

After being forced to wait for the New York State Courts to reopen, parties flood the court with litigation concerning transactions that failed to close before the COVID-19 pandemic.

By Michael Mix and Jason Gottlieb, *New York Law Journal* – July 8, 2020.

What should a party do if, before the COVID-19 pandemic, it entered a transaction to purchase assets, but the closing was scheduled for a date after the pandemic began? Economic conditions in numerous industries have changed significantly as a result of the pandemic, and the value of certain assets may have decreased—or, in some cases, increased. Purchasers in this situation undoubtedly wish that they had access to a time machine, to warn their past selves that the world was about the change. But failing access to a DeLorean with the ability to hit eighty-eight miles per hour, some parties are instead turning to the next best thing—the court system—in order to attempt to unwind transactions where a purchase agreement was signed but the deal never closed.

On the flip side, some sellers of assets are trying to enforce those deals, to lock in the purchase price reached before the economic effects of the pandemic. Where purchasers have indicated that they do not plan to close on a given transaction, some sellers are also seeking access to the court system, to enforce those deals.

In numerous cases all around the country, purchasers or sellers have sought either to enforce or to escape transactions that never closed. For example, in late April, competing claims were brought in the Court of Chancery of the State of Delaware by a purchaser and seller after the putative purchase of a majority stake in retailer Victoria's Secret failed to close—though the claims were later withdrawn after the parties reportedly settled their differences.

Parties in New York seeking recourse concerning failed transactions have faced some roadblocks. Pursuant to Administrative Order 78/20 issued on March 22, 2020 by the Chief Administrative Judge of the Courts, parties seeking access to the New York state court system had been unable to file new actions (except limited essential matters) after that date, and until recently. Accordingly, unless a party had the ability to file an action in federal court, in an arbitral forum, or in a state where the courts remained open, parties in New York simply had to wait.

That changed on Monday May 25, 2020, when the New York State court system finally permitted the filing of new, non-essential cases in all New York counties, even those that had not met the benchmarks required to participate in the state's reopening plans (such as the five counties in New York City). Unsurprisingly, a flood of new cases were filed on May 25 and May 26. Among these cases were complaints filed by purchasers or sellers concerning purchases that never closed. This article outlines three such complaints, involving the purchase of a pool of mortgage loans, the purchase of a company, and the purchase of real estate.

Cascade Funding, LP—Series 6 v. The Bancorp Bank, Index No. 651841-2020, New York Supreme Court, New York County. On Feb. 24, 2020, the plaintiff agreed to buy a pool of commercial mortgage loans from the defendant, which the plaintiff planned to securitize as a "commercial real estate collateralized loan obligation," or a "CRE CLO." The agreement between the parties contains a "market disruption" clause permitting the plaintiff to cancel the agreement if the plaintiff could provide written evidence to the defendant that the highest rated tranche of bonds in the securitization would price at a rate over 200 basis points over LIBOR—an interesting detail, because, unlike many "material adverse event" clauses, this one is specific and quantitative. The closing was scheduled for April 15, 2020.

The plaintiff alleged that as a result of COVID-19 and the related shutdowns and economic downturn, the market for CRE CLOs collapsed as a result of rampant forbearance requests from borrowers on the underlying loans. The plaintiff thus obtained a written statement from the lead manager for the securitization that the bonds in the AAA tranche were priced higher than 200 basis points over LIBOR. On that basis, the plaintiff invoked the Market Disruption clause in the contract, purported to terminate the agreement, and sought the return of its deposit. The defendant contended that the termination was unjustified because the plaintiff had not provided evidence of actual bids from investors, and sought to keep the deposit. The plaintiff initiated an action for breach of contract and seeking the return of the deposit.

Telefonica, S.A. v. Millicom International Cellular S.A. and Millicom Spain S.L., Index No. 651838-2020, New York Supreme Court, New York County. The defendant agreed to purchase the plaintiff's subsidiary, a Costa Rican mobile phone company. The parties entered into the purchase agreement in February 2019, but the parties were obligated to obtain a number of regulatory approvals by the Costa Rican government before they were permitted to close. The plaintiff alleged that all the approvals were received effective March 21, 2020, and it sought to close on April 13, 2020.

However, the plaintiff-seller alleged that the defendant's stock price plummeted after the COVID-19 outbreak, and that the defendant therefore began to have buyer's remorse about the transaction. The defendant asserted that additional approvals needed to be obtained, and did not attend the closing that the plaintiff scheduled for April 13, 2020. The plaintiff filed an action, seeking specific performance of the defendant's obligations under the purchase agreement.

SLG 220 News Owner LLC and SLG 220 News Lessee LLC v. CF 42 Fee LLC, CF 42 Lessee LLC, and Fidelity National Title Insurance Company, Index No. 651857-2020, New York Supreme Court, New York County. The parties entered into a purchase agreement on September 27, 2019, under which the defendant agreed to purchase from the plaintiff real property on 42nd Street in Manhattan. The closing was scheduled for March 17, 2020.

The defendant-purchaser informed the plaintiff that it couldn't close on March 17 because the defendant's lender was suspending work on all pending loan transactions. The parties subsequently moved the closing date to March 20. On March 19, 2020 the defendant informed the plaintiff that the "corrosive impact" of the pandemic had made its performance under the

agreement impossible and impracticable. The defendant sought the return of the deposit. The plaintiff disagreed and initiated an action seeking a declaratory judgment that the defendant had defaulted under the purchase agreement and the plaintiff was entitled to retain the deposit.

Conclusion

It remains to be seen how these cases, and others like it, will be resolved in the months and years to come. However, "busted deals" will undoubtedly be a prominent genre of litigation to emanate from the COVID-19 crisis. As with many commercial matters, the language of the purchase agreement may dictate the result—or, at least, a likely enough result that the parties can reach a settlement without resorting to the courts. However, few material adverse event clauses are as specific as in the *Cascade Funding* case—and even in those cases, the quantitative measures may be subject to challenge, given the uncertain effects of the crisis on any valuation issues. So it will fall to the courts—which are thankfully opening up again—to decide when parties must stick to their original agreements, or when agreements may be abandoned or modified due to the COVID-19 pandemic and its many economic effects.

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