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Buyers Beware - Delaware Chancery Court Orders CorePower to Honor Acquisition of Franchisee Studios

On March 1, 2022, Vice Chancellor Slight of the Delaware Chancery Court ordered CorePower Yoga (“CorePower”) to close the acquisition of 34 yoga studios from its largest franchisee, Level 4 Yoga (“Level 4”).¹ The parties entered into an Asset Purchase Agreement on November 27, 2019 (the “APA”) contemplating CorePower’s acquisition of the Level 4 studios in a series of staggered closings. King & Spalding represented the seller, Level 4, in this transaction.

As the United States began to feel the impact of COVID-19 in March of 2020, CorePower approached Level 4 requesting to delay the closings. Level 4 refused to push back any of the closings, leading CorePower to claim, 5 days before the initial closing scheduled to occur on April 11, 2020, that Level 4 had “repudiated” the APA due to breaches of representations, including representations related to Material Adverse Effect and ordinary course operations, and therefore, CorePower was no longer obligated to close the transaction.

The Court found that the APA was intentionally structured as a “one-way gate”, and that there were no other common law principles that would excuse CorePower’s performance. The Court ordered CorePower to consummate the acquisitions and pay Level 4 the full amount of the purchase price, plus the amount of operating losses incurred by Level 4 while it continued to hold the studio assets pending resolution of this dispute, plus additional damages and interest.

“ONE-WAY GATE”

The parties’ entry into the APA arose out of a call option (the “Call Option”) granted to CorePower in the franchise agreements with Level 4. The Call Option granted CorePower the right to purchase the Level 4 studios, which was triggered when TSG Consumer Partners, a private equity firm, purchased CorePower. While the Call Option required the

closing of the acquisition of all the studios in a single transaction within 60 days following exercise, CorePower asked Level 4 to stagger the closings because it was concerned about potential integration challenges. Level 4 agreed, which led to the entry into the APA. However, given the fact that the staggered closings arose out of an accommodation to CorePower, the APA contained “no conditions to closing, no express termination provisions, and no termination or reverse termination fees; there is not even a force majeure clause”. The Court found that the lack of such provisions provided “potent evidence of the parties’ intent”, which was to create a “one-way gate” where CorePower’s remedies for any breach of the APA by Level 4 prior to closing “did not include termination”.

COMMON LAW TERMINATION RIGHTS

While the Court found that the APA clearly required CorePower to close the transaction, CorePower alternatively argued that various common law justifications gave it the right to terminate the APA and not close, including (1) repudiation, (2) frustration of purpose, and (3) material breach.

As a threshold question, the Court determined that the date CorePower declared it would not close was the appropriate time of measurement for Level 4’s performance under the APA – actions taken by Level 4 after CorePower’s refusal to close could not be used to justify a refusal to close. “[W]hen CorePower communicated to Level 4 that it would not perform under the APA as of March 26, the bargained-for structure of the APA was lost, and when that was lost, so too was CorePower’s justification for non-performance based on subsequent actions or omissions by Level 4”.

The Court then addressed various common law arguments raised by CorePower to justify its non-performance:

1. Repudiation

CorePower first argued that Level 4 had repudiated the APA, and as such, CorePower was not obligated to close. This was the justification asserted by CorePower in its communication to Level 4 prior to the initial closing, asserting that Level 4 had “repudiated multiple material obligations embodied in the [APA]” and thereby “discharge[ed] [CorePower’s] obligations thereunder”. Repudiation permits a party to terminate a contract in response to a counterparty’s unconditional refusal to perform the contract as promised, whether by word or deed.

In arguing repudiation by word, CorePower relied on an email exchange wherein Level 4 wrote that COVID-19 has “[Level 4’s] operating mode no longer in the ordinary course of business”. The court found CorePower’s characterizations of this email to be “litigation-driven hyperbole”, and that the parties were “speaking in general terms and not specifically referring to the APA’s Ordinary Course Covenant”. In the broader context of the communications leading up to the first closing date, the Court found that Level 4 had illustrated a commitment to close, notwithstanding this single sentence taken out of context.

CorePower also argued that Level 4 repudiated by deed by “disavow[ing]” certain contractual obligations, including (1) not experiencing a material loss, (2) not terminating or closing any facility, (3) not experiencing a Material Adverse Effect, and (4) conducting the business in the ordinary course. The Court addressed each of these in turn:

- **Material Loss:** The APA contained a representation that there had been no “material loss” affecting the Business or an “Acquired Asset with a value in excess of \$50,000”. The Court found that, even if it accepted CorePower’s interpretation that any loss of \$50,000 would breach this representation, that as of the date of CorePower’s refusal to close, the business had not experienced such a loss.
- **Studio Closures:** CorePower argued that due to studio closures in light of the COVID-19 pandemic, Level 4 had repudiated the APA by breaching its representation that it had “not terminated or closed any facility, business or

operation”. The court focused on the fact that repudiation requires a “voluntary act”, and that both CorePower, as the franchisor, and government mandates required such closures. Furthermore, at the time of CorePower’s refusal to close, CorePower’s internal documents showed that it expected the closures to last for six weeks, which “hardly evidence[d] outright refusal and inability to perform”.

- **Material Adverse Effect:** CorePower also argued that Level 4 experienced a “Material Adverse Effect”, which led to a breach of Level 4’s representations that constituted a repudiation of the APA. In evaluating whether an MAE had occurred as of the date of CorePower’s decision not to close, the Court focused on durational significance, noting the impact of an MAE is typically thought of as being “measured in years rather than months”. As of the date of the first closing, CorePower management, in a report to the board, forecasted that COVID-related studio closures would last six-weeks, which the Court found “hardly durationally significant under any measure”. The Court also noted that CorePower itself certified that no MAE had occurred with respect to its business as of March 19, 2020 when it drew upon its term loan.
- **Ordinary Course of Business:** CorePower’s final attempt to rationalize its repudiation claim was that Level 4 breached its covenant and representation to operate in the Ordinary Course of Business as a result of studio closures, employee layoffs and various other actions taken in light of the COVID-19 pandemic. Focusing on the pre-April 1 studio closures and employee furloughs, the Court recognized the unique franchisor/franchisee relationship of the parties. In short, Level 4’s “Ordinary Course of Business” was to follow the direction of CorePower as franchisor under the franchise agreements. Therefore, while studio closures and employee furloughs may have been “extraordinary, the practice of following the direction of the franchisor was entirely ordinary and consistent with past practice”.

2. Frustration of Purpose

CorePower also argued that its performance under the APA was excused because “the purpose of the APA was frustrated by Level 4’s post-signing conduct”. In evaluating this argument, the Court noted that this argument arose only in the course of litigation, and was not proffered as a basis for non-performance when CorePower declared it would not close the transactions. The frustration of purpose doctrine applies when “(1) there is substantial frustration of the principal purpose of the contract; (2) the parties assumed that the frustrating event would not occur; and (3) the [d]efendant is not at fault”. The Court noted that the frustration of purpose doctrine “is very difficult to invoke” and that the Court is “extremely reluctant to allow parties to disavow obligations that they have agreed to”. The Court summarily dismissed this argument given that there was no repudiation or material breach of the APA, and that the yoga studio closures, which were at the heart of CorePower’s argument with respect to frustration, “occurred in direct response to CorePower’s own direction”.

3. Material Breach

The Court again noted that CorePower’s arguments as to material breach emerged in litigation, as opposed to as the time of CorePower’s refusal to close. A material breach for purposes of excusing contractual performance requires a breach so material that “it goes to the root or essence of the agreement between the parties, or touches the fundamental purpose of the contract and defeats the object of the parties in entering into the contract”. The Court analyzed the litany of alleged breaches raised by CorePower and noted that it appeared that “CorePower simply went down the list of the seller’s ... representations and checked any that might arguably be implicated by events that transpired after it declared it would not perform”. Many of these were duplicative of the alleged breaches raised in the context of CorePower’s repudiation argument. The Court found that, similar to the repudiation claims, evidence of “material breach is sorely lacking” and that “none of the alleged breaches of the APA were consequential enough to excuse CorePower’s performance”.

Having found that there was no contractual or common law excuse for CorePower’s non-performance, the Court found in favor of Level 4, and ordered that the transactions be consummated, and that CorePower pay the transaction consideration plus damages and interest.

CONCLUSION

The Court’s analysis reflected the unique circumstances of the transaction – namely, the background regarding the Call Option and the relationship of the parties as franchisor / franchisee. However, the decision still provides important guidance as to the significance the Court will place upon the express provisions of a purchase agreement – or here, the lack of certain customary provisions such as closing conditions and termination provisions. The decision also provides significant discussion of the Court’s interpretation of typical contractual language, including ordinary course of business and material adverse effect, in the context of extraordinary circumstances such as the COVID-19 pandemic.

The decision illustrates the significant potential risk that buyers assume when they refuse to close a transaction absent a clear contractual right to do so: “[CorePower] could have proceeded to close on April 1 as it was contractually obliged to do and then invoke its post-closing remedies, or it could go “all in” by refusing to close (or otherwise honor the APA) purportedly as a matter of common law right”. In this instance, the specific performance provision in the APA clearly gave the seller the right “to enforce specifically this Agreement”, plus “any other remedy to which [they] may be entitled, at law or in equity”. The seller, Level 4, fully received its benefit of the bargain, plus other damages incurred during the period when the seller was forced to sue the buyer in court in order to obtain its benefit of the bargain, plus other damages and interest.

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¹ *Level 4 Yoga, LLC v. CorePower Yoga, LLC, CorePower Yoga Franchising, LLC*, No. CV 2020-0249-JRS (Del. Ch. Mar. 1, 2022).