M&A Report
2021

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Rising regulation requires agility from M&A deal teams

Nick Cline, Robbie McLaren, Douglas Abernethy and Catherine Campbell of **Latham & Watkins** consider key developments likely to impact M&A in 2021, and how dealmaking is likely to progress in light of these developments

If 2020 was the year that COVID-19 precipitated extraordinary government intervention and regulation of our lives, 2021 looks set to be the year that regulatory interventions in M&A precipitate changes to the way that dealmakers approach transactions.

After a disrupted first half of 2020 and a respectable rebound later in the year, M&A market sentiment for 2021 is generally positive. Absent unanticipated shocks, factors including the resolution of Brexit, a new US administration, and the widespread rollout of COVID-19 vaccines bring expectations of a busy year ahead for deals.

As regulators and governments push to introduce or enhance a wide range of rules impacting investments in multiple sectors, dealmakers should expect that the hand of government will still be felt, even for businesses not traditionally viewed as 'regulated'.

Successfully executing an acquisition in 2021 will require skilful navigation of a complex and evolving legal and regulatory landscape — and deal teams must remain agile to successfully clear hurdles.

Anticipated changes

CMA to take more prominent role in global deals

Amid the changes to UK laws and regulations brought about by Brexit, the end of the transition period means that acquirers face parallel EU and UK competition investigations — with the effect that the UK's Competition and Markets Authority (CMA) will play a more prominent role in reviewing global M&A deals.

Dealmakers must be alert to the increasingly interventionist approach of the CMA, including in transactions with a limited nexus to the UK. This is likely to increase the regulatory burden on acquirers, including for non-problematic cases, since the CMA has no equivalent to the EU's 'short form' procedure, which allows for a more truncated and less burdensome notification in simple cases.

The increase in workload is also the result of the CMA taking an expansive approach to jurisdiction. Cases such as Sabre/Farelogix and Roche/Spark demonstrate that the CMA is making dynamic, forward-looking assessments of parties' overlaps, even in cases in which the target had no revenues directly attributable to the UK.

Economic nationalism drives creation of new FDI screening regime

Growing economic nationalism is threatening to impact M&A across Europe.

Multiple jurisdictions are actively enforcing foreign direct investment (FDI) screening regimes and intervening in the acquisition of strategically important companies.

In November 2020, the UK government published its long-awaited National Security and Investment Bill (NS&I Bill), which is expected to come into effect later this year but will have retrospective review powers over certain investments. The NS&I Bill includes powers to void, prohibit or unwind transactions, mandatory notification and preclearance for investments relating to 17 broadly defined sectors (considered to be sensitive from a national security perspective) and voluntary notification for other sectors.

While the government has indicated that investment in the UK is still actively encouraged, the scale of the proposed changes means that a significant number of transactions are likely to be caught.

Increasingly assertive pensions regulator to gain new powers

With multiple employers deferring deficit recovery contributions in 2020 and growing holes in defined benefit pension plans, pension liabilities should be front of mind for dealmakers — especially as the Pensions Regulator will gain enhanced powers later this year.

Unlike the NS&I Bill, the Pension Schemes Act will not have retrospective effect, however, it expands the circumstances in which the Pensions Regulator can exercise existing moral hazard powers. The Pension Schemes Act also creates new moral hazard powers that can be exercised against any 'person' and includes penalties that encompass criminal sanctions. Given increasing political and public pressure on the Pensions Regulator, dealmakers should anticipate increased scrutiny of deals that involve a defined benefit pension plan.

The global regulatory direction of travel: More enforcement

This year is likely to bring a general step-up in enforcement, as regulators increasingly coordinate efforts, share learnings, and seek to take action on a growing range of issues and perceived concerns.

Amid the tumult of 2020, the risk of short-term corporate decisions having long-term financial and reputational consequences is heightened. Large and well-publicised fines, including for bribery, cyber and data breaches, and cartel behaviours, mean that dealmakers must remain alert to the risk of inheriting liabilities for historical regulatory non-compliance.

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How should dealmakers respond?

Assess the opportunity

This year the market is likely to place a greater emphasis on deal planning and critical assessment of regulatory risks, including developing a strategic regulatory clearance plan focused on managing the impact of filings, clearances, and other hurdles. Nascent regimes and amended approaches mean that work is required to mitigate unexpected delays or remedies. If a transaction falls within scope of a particular regime, screening processes may well involve extensive disclosure requirements that can impact deal timetables, creating barriers to closing.

More clients have undertaken a merger control-style analysis of FDI approval issues, including analysing their own shareholder base and that of any other investors involved in the deal. Deal teams should consider opening a dialogue with regulators to allay concerns.

For problematic cases, dealmakers should consider what remedies or undertakings they might be willing to accept, and how this would impact deal value. Balancing the requirements of different regulators in different jurisdictions requires agility.

The Committee on Foreign Investment in the United States (CFIUS) may accept undertakings as a condition of clearance, including prohibiting or limiting the transfer of certain intellectual property, trade secrets, or know-how.

The UK government has also accepted undertakings (e.g. in Advent's 2019 takeover of aerospace company Cobham). However, differences in process between the CMA and other antitrust regulators are likely to create challenges in ensuring that remedy offers can successfully straddle the EU and UK systems effectively.

Allocate risk and uncertainty

Deal documents will need to respond to the regulatory framework to which the transaction and the target company are subject or will become subject once new legislation is fully implemented.

Latham's 2020 Private M&A Market Study — which examined more than 260 European deals — found that FDI approval conditions were beginning to increase between 2018 and 2020 but remained relatively uncommon, and were seen in just 11% of deals.

By comparison, the prevalence of FDI conditions is significantly less than that of merger control conditions, which were included in 54% of deals analysed. This appears likely to change, given the expansive scope of the NS&I Bill and similar regimes applicable in other jurisdictions. Dealmakers should consider terms and scope of such conditions and the efforts that parties are compelled to take to satisfy them, in addition to the implications on deal timetable and, in some cases, deal certainty.

Further, compressed deal timetables and a sellers' market in recent years have contributed to a downward trend for liability caps on warranty claims — 65% of sellers in Latham's 2020 Private M&A Market Study limited their commercial warranty liability to less than 20% of equity value, compared to 41% in the 2014 edition.

While buyers may have sought additional warranties, indemnities, and post-closing price adjustments to mitigate the uncertainties of 2020 (including fines and other regulatory risks), the M&A market for attractive assets has remained competitive, meaning that acquirers are frequently forced to accept less-than-perfect deal protections. This emphasises the importance of a detailed regulatory diligence exercise and the potential need, in some cases, for a risk-based post-closing audit and remedial processes.

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Mind the gap

Gap covenants governing the conduct of the target business between signing and closing came under heightened scrutiny in 2020, as dealmakers debated what type of business conduct counted as 'ordinary course' in extraordinary times.

In an increasingly regulated M&A environment, deal teams should expect a greater focus on these covenants, particularly given lengthening timelines between signing and closing. Buyers need sufficient control of and confidence in the operation of the business by the seller, but without having full control through equity ownership, always being cognisant of gun-jumping rules.

New deals, new challenges

Special purpose acquisition companies (SPACs) emerged, somewhat unexpectedly, as the hottest market trend in the US in 2020, allowing SPAC sponsors to launch shell companies with the goal of taking private companies public via merger.

The launch of European-style SPACs, the growing number of triple-track deal processes (i.e. with an auction sale, an IPO, and a SPAC sale as possible outcomes), and increasing instances of stressed or distressed M&A present novel, complex deal structures and new challenges — all of which require agile legal advisers who are able to navigate regulatory interventions and give dealmakers the competitive edge.

Germany

Nikolaos Paschos and Sebastian Goslar, Latham & Watkins

After a severe slowdown of deal activity in the first half of 2020, the German market now appears quite resilient despite the challenges resulting from the COVID-19 pandemic. Potential buyers nonetheless remain cautious, more than ever aiming for a fair assignment of risks. Thus, there has been a noticeable increase of minority investments and joint ventures. Cross-border, as well as domestically public M&A transactions have also received growing interest from private equity (PE) investors.

Public and private M&A both play an important role in German transactional practice. Private deals often dominate the market as the number of listed companies is not as big as in other markets and there are some peculiarities to the German law that make the full integration of a listed company complex and difficult to assess from a financial perspective.

The spin-off of Siemens Energy from the Siemens Group and its subsequent listing in the prime standard of the Frankfurt Stock Exchange is a good example of a deal structure that has been encountered more often in recent months and which will likely continue to be attractive under COVID-19 restrictions. The transaction comprised a spin-off of the energy business to a newly established company, Siemens Energy, that has subsequently been listed on the Frankfurt Stock Exchange.

COVID-19 and recovery plans

There is a clear shift by businesses to move towards digitalisation, a progression that would likely spur M&A activity by companies seeking to improve their capabilities in this space.

The substantial capital markets activity that the technology industry has seen will also impact the M&A process. In particular, companies that view the IPO road as a credible alternative to a sell-side liquidity event can use this leverage to drive better terms in an M&A event.

The trend towards increased public M&A activity is confirmed by the notable rise in dual-track and even tri-track processes. Growth equity also rose significantly, as Europe's start-up scene further matures. In the US, the tech industry has also seen a rise in the number of direct listings and special purpose acquisition company (SPAC) transactions. It remains to be seen whether these trends will also manifest in Germany.

"One of the drivers in M&A for the next few years will be distressed M&A"

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The healthcare and life sciences (HCLS) sector also experienced strong deal activity throughout 2020 despite the uncertainties caused by the COVID-19 pandemic. This trend, which had already started before the pandemic outbreak, has only accelerated due to the disproportionately large impact that the virus has had on certain other sectors of the economy (e.g. logistics, real estate, automotive, hotels/travelling).

Corporates clearly focus on their core activities, spinning-off and carving-out business units that do not perform or support the main business. Further acquisitions of minority stakes in listed companies, including by way of private investment in public equity (PIPEs), are also on the rise.

One of the drivers in M&A for the next few years will be distressed M&A. Not only financial investors are revisiting old targets to spot distressed assets, but also activists are increasingly focusing on capital structure imbalances, vulnerabilities, and management responses to the pandemic. So far, activist investors have been relatively quiet, however, they have quietly accumulated equity positions, and larger corporates continue to be seen as value plays.

Legislation and policy changes

Acquisitions of private companies are primarily structured as share deals and are in principle not governed by a legislative offer process but are rather a matter of negotiation between the respective bidder and seller as most of the applicable general rules of the civil and corporate law is not mandatory.

Public M&A transactions on the other hand have to comply, *inter alia*, with the German Securities Acquisition and Takeover Act (WpÜG), the Market Abuse Regulation (*Marktmissbrauchsverordnung*) and the German Stock Corporation Act (AktG). Furthermore, public takeovers are subject to the supervision of the German Federal Financial Supervisory Authority (BaFin).

The Federal Ministry of Economics (BMWi) has the power to review direct or indirect acquisitions of voting rights in German-based companies by foreign investors. The BMWi may prohibit a transaction or request commitments if it poses a threat to German public order or security or violates essential national security interests.

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Sebastian provides clients pragmatic and efficient advice, drawing on his broad experience with more than 150 transactions. He writes frequently on corporate and takeover law, including in the 'German Public M&A Handbook (*Handbuch Übernahmerecht nach dem WpÜG*)'.

In addition, public and/or private M&A transactions that are deemed a concentration may be subject to German merger control.

As distressed M&A market will be one of the drivers in M&A for the next few years, the Act on the Further Development of the Restructuring and Insolvency Law (SanInsFoG) that the German legislator passed on December 17 2020 is of utmost importance. It implements a wide catalogue of restructuring instruments offering debtors the opportunity to implement a restructuring concept with the support of a majority of creditors against obstructing creditors. Many of the companies currently in distress actually only face liquidity or over-indebtedness problems; their core business is intact and will remain so after the COVID-19 pandemic. Under the new legislation, restructuring can be carried out in a minimally invasive manner and potential investors need not fear hold-out value creditors when it comes to financial restructuring.

The Digitalization Act, which entered into force on January 19 2021, substantially extends the scope of German antitrust law to tackle presumed enforcement challenges in the digital economy and raises merger control thresholds across all industries. The Digitalization Act is the 10th amendment of the German Competition Act (GWB), the so-called 'GWB10'. Among other important changes, the current merger control thresholds have been substantially raised in order to relieve (mid-sized) companies from notifying transactions of minor economic importance.

Finally, foreign investment control has been tightened and carefully assessed, in particular by non-EU parties in certain key sectors.

M&A decision-making is influenced more and more by environmental, social and governance (ESG) matters when evaluating investment opportunities. ESG has reached an inflection point, with boards of directors, investors and other market participants and observers focusing on questions regarding corporate purpose and recognising the critical importance of environmental, social and governance factors in the sustainability and long-term value creation potential of the corporation and, ultimately, broader economic prosperity.

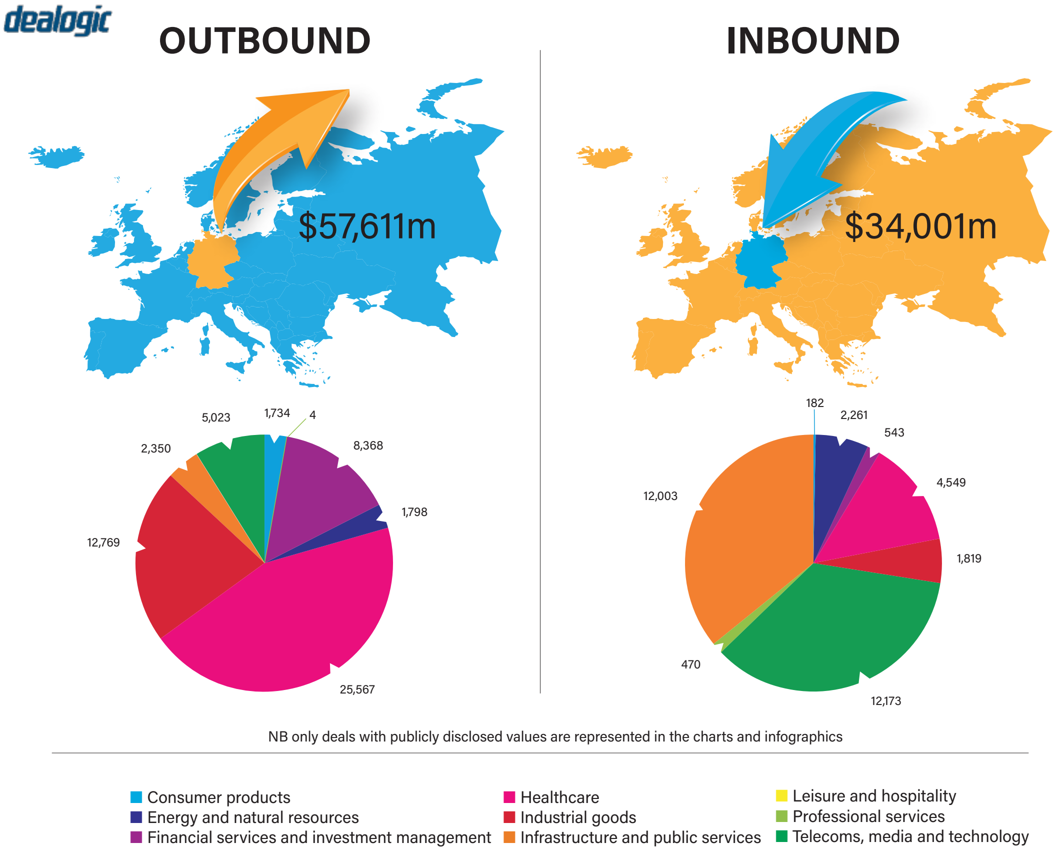
Market norms

In the majority of private M&A transactions, shares in a German limited liability company (GmbH) are sold by way of a share purchase agreement (SPA). The disposal of GmbH shares requires notarisation of the SPA including all annexes which in fact means that the notary public must read out loud the SPA in front of the parties involved.

Depending on how complex the transaction is, this may be a rather lengthy exercise that needs to be interrupted each time one of the signing parties leaves the room or talks on the phone. Therefore, it is customary to have authorised representatives to sign the documentation.

Depending on the deal structure, it is highly advisable to seek employment and tax law advise early in a German M&A deal as German law provides some unique peculiarities in these legal practices.

Law firms are using artificial intelligence (AI) tools more and more, i.e. to conduct due diligence in M&A transactions while also using e.g. project management and translation tools to assist with a smooth transaction through to closing.



Electronic and digital signatures and digital transaction management platforms, such as DocuSign, are making it easier to execute M&A transactions. It enables parties to review the final documents and sign electronically, which can overcome significant logistical issues for complex global transactions where parties are in difference locations and time zones. However, most of the German private M&A transactions involve the transfer of GmbH shares that require notarisation and thus is currently not eligible for electronic signature.

Public M&A

A shareholder holding at least 30% of the voting rights in as listed company has 'control' over the company according to German takeover law.

The scope of legal documentation required for the assumption of shares in a public company depends on the type of business combination chosen, i.e. reorganisations and mergers, acquisitions of a certain stake or a public takeover, or cooperation models as well as on the type of shares being acquired (namely bearer shares, registered shares, etc.) and whether these shares were bought over the stock exchange, subscribed for in connection with a capital increase or bought from other shareholders. Depending on the structure of the transaction, more documentation than only a purchase agreement may be required.

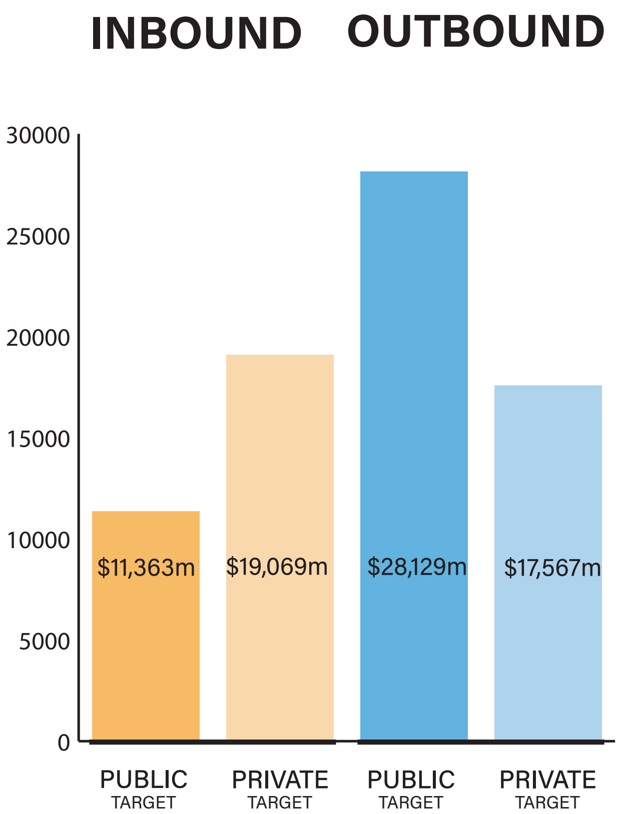
A public tender offer requires an offer document governed by German law. Unsolicited takeover attempts are still rare in Germany, however, the general attitude with regard to hostile transactions is less negative than it was in the past. Private and institutional investors increasingly encourage stock corporations to focus on shareholder value as liquidity and transparency of capital markets have developed.

After the decision to launch an offer has been published, the management board must not take any action that could prevent the success of the takeover offer. However, the following actions of the management board (including defensive measures) are permitted, without approval of the shareholders' meeting:

- Searches for a 'white knight';
- Any action within the scope of the management board's powers if approved by the supervisory board and if the law (e.g. the AktG) does not set forth further requirements; and
- Actions that would have reasonably been taken if no offer had been launched, for example, measures in the ordinary course of business, measures to execute contractual obligations entered into before the bid or measures executing the established strategy of the target company.

Furthermore, the shareholders may, under certain restrictions, authorise the management board to take actions within the scope of the powers of the shareholders' meeting before and independent from any takeover offer.

The BaFin takes a rather restrictive position regarding offer conditions. Voluntary public takeover offers are usually subject to regulatory approvals, fairly standardised market- and company-material adverse changes (MACs) and no defensive measures, such as capital increases during the offer period, being taken. There is often a minimum acceptance threshold. Mandatory offers, i.e. those triggered by reaching a minimum 30% shareholding, can only be subject to regulatory conditions.



NB: Values may exclude certain transactions, for example asset acquisitions/sales

Break fees in public M&A deals, when the target pays the prospective buyer, have traditionally been unpopular in Germany and few target companies or bidders are willing to accept a break fee.

Private M&A

According to the Latham & Watkins 2020 Private M&A Market Study (the study), which examined over 260 deals signed between July 2018 and June 2020, 47% of deals included a locked-box mechanism, 25% of deals included a completion accounts mechanism and 28% of deals did not provide for price adjustment. This trend is consistent with results from the previous four editions of the study and reflects the seller-friendly nature of the European M&A market until COVID-19 emerged in March 2020.

Thereafter, buyers found pricing deals using locked-box mechanisms far more challenging given the significant changes seen in company earnings and the lack of reliable financial forecasts. Whether Germany—under the given circumstances—returns to the prevalent usage of completion accounts remains to be seen.

The number of deals that featured an earn-out remained limited at 18% (albeit an increase of 4% from the previous study) according to the study. Earn-outs are less popular with PE sellers. However, as valuation uncertainties continue, earn-outs may serve as a means to unlock the gap between buyers and sellers, although COVID-19 disruption and many of the challenges that made valuation tricky during deal negotiation are likely to remain during the earn-out period. Therefore, careful specification of financial performance metrics is essential.

"The market for exits still remains resilient"

The study also revealed the continued limited use of escrows in private M&A deals (19% of deals surveyed, a third successive year of escrows featuring in 20% or less of deals), and a steady use of warranty and indemnity (W&I) insurance (45% of German deals). For deals that were signed in the first half of 2020, there was even an increase in the prevalence of escrows to 25%, reflecting changing business conditions and ongoing COVID-19-related uncertainties.

Private M&A transactions are typically subject to:

- Merger control clearance by the Federal Cartel Office or the European Commission; and
- Foreign investment control clearance by the BMWi.

Further deal conditions, if any, depend on the transaction specifics.

SPAs relating to German targets are usually governed by German law and are subject to the German courts unless the parties have agreed on arbitration. For cross-border deals, depending on the role and strength of the parties involved, purchase agreements are frequently governed by German law but may alternatively be subject to the laws and courts of another jurisdiction.

However, German law applies a twofold approach, i.e. the purchase agreement determines the framework under which the shares are sold whereas the transfer agreement determines how and when title to the shares actually transfers to the buyer. While the parties are generally free to choose the governing law for the purchase regulations of a transaction, the actual transfer of the shares must be governed by German law.

Due to the remaining uncertainties of the COVID-19 pandemic, there is no reliable valuation basis that consequently makes appropriate pricing very difficult for all parties involved. Whereas strategic investors implement risk sharing structures such as earn-outs for acquisitions, these are impracticable for PE exits, which call for the distribution of funds.

Under the current circumstances, nobody sells who is not forced to sell. Appropriate pricing is hardly possible without a reliable basis for valuation. Therefore, PE follows a 'buy and build' strategy to create value by pursuing COVID-19 related opportunities. Implementing such an approach takes time and therefore requires longer holding periods.

IPO exits are on the rise, more so than trade sales but secondaries have factually dropped off. With regards to the exit environment, the market for exits still remains resilient, with sellers seeking an IPO (or merger with a SPAC) or sale to realise their investment; in some instances, sellers employ dual-track exits to give greater certainty that an exit will occur.

Looking ahead

Strategic investors have and will continue to pursue transactions to improve their competitiveness in an increasingly digital and rapidly changing world. To face the uncertainties caused by the COVID-19 pandemic, companies will continue to review their portfolios and dispose non-core assets as well as unprofitable business units by way of spin-offs or carve-outs. The proceeds will likely be used for investments in innovation, digitalisation and disruptive technologies. The disposed assets on the other hand continue to attract PE investors in hope for superior returns on a stand-alone basis.

Despite COVID-19, PE firms are still sitting on a huge amount of dry powder for which they seek investment opportunities. Starting already before COVID-19, PE investors have proved to be more flexible with regard to investment structures. In an aim to mitigate COVID-19-related uncertainties, it is expected that there will be significantly more minority shareholdings and co-investments.

The uncertainty about the short and long-term consequences of the pandemic and the respective influence on the business of potential target companies cause high insecurity with regard to reliable company evaluations. This will and already has inevitably influenced transaction structures, i.e. re-participations, earn-outs and vendor loans will be on the rise to bridge evaluation uncertainties.

It is projected that PE firms will not act on the sell side as often as in the past so that so-called 'secondary transactions' will significantly decrease until the market and the portfolio companies have stabilised. A lot of companies struggle hard due to the COVID-19 crisis so that competition for healthy and promising targets among PE investors but also between PE and strategic buyers will markedly increase.

Hong Kong SAR

Simon Cooke, Amy Beckingham, Frank Sun, Terris Tang and Maurice Conway,
Latham & Watkins

While Hong Kong SAR saw a modest decline in the number of M&A deals for 2020, the total deal value rose overall compared to 2019, thanks to a solid recovery in the second half of the year. There has been an increase in outbound activity, with a focus on Chinese target companies.

Heightened geopolitical tensions and logistical difficulties caused by COVID-19 have presented challenges to cross-border deal-making, resulting in lengthened deal timetables and market uncertainty as buyers conduct more-detailed due diligence exercises to assess the commercial and regulatory risks of their targets.

Hong Kong SAR continues to be a hub for large-scale private and public M&A transactions. However, due to depressed equity valuations in 2020 resulting from the pandemic, there has been an increased number of take-private and private investment in public equity (PIPE) deals. The state of the capital markets overall heavily influences deal pricing and valuations, particularly in the case of public transactions.

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COVID-19 and recovery plans

Despite experiencing an initial slowdown in M&A deal volume, Hong Kong SAR experienced a strong rebound in the second half of 2020 as it started to recover from the effects of COVID-19.

The pandemic has spurred activity in the healthcare and life sciences industry globally, including in Hong Kong SAR, where there has been increased private equity (PE) interest in the acquisition of biotech and healthcare companies. Investment in this industry has had the benefit of the new listing regime, which was introduced last year and allows for pre-revenue biotech companies to apply to list on the Hong Kong Stock Exchange (HKEX).

COVID-19 has had a significant influence on how deals are structured. Market uncertainty has made it difficult to value targets and forecast future performance. Buyers are considering their walk-away rights more carefully, leading to negotiation of more favourable material adverse change (MAC) clauses, although enforcement of MACs remains an issue.

Difficulty in agreeing company valuations has meant that completion accounts mechanisms are being favoured by buyers as a way to mitigate the risk of shifts in the value of businesses pre-completion. Buyers are also using earn-outs or deferred consideration structures to address the risk of unforeseeable disruptive events.

"New legislation enables private funds to be registered in the form of limited partnerships"

The last few years have seen active PE participation, fuelled by a stockpile of dry powder amassed from successful fund-raising by PE funds. Despite the uncertain market, PE is likely to remain a driving force in the market going forward.

The M&A market in Hong Kong SAR has proved itself robust in the last 12 months, and despite the continuing pandemic, the relatively strong rebound seen in the second half of 2020 combined with positive vaccine news has paved the way for a steady recovery in 2021.

The pandemic, along with the uncertain geopolitical landscape, including trade tensions between the US and China, means investors will continue to approach M&A cautiously, focusing on growing existing businesses and looking for niche or perceived quality opportunities for investment.

Legislation and policy changes

M&A transactions involving public companies or companies with a primary listing of their equity securities in Hong Kong SAR are subject to the regulations of the Code on Takeovers and Mergers (Code), which is administered by the Securities and Futures Commission (SFC), the Listing Rules, and the Securities and Futures Ordinance.

Against a backdrop of COVID-19, the increasing trend of protectionist policies by international governments, as well as trade tensions and geopolitical uncertainties, are likely to be challenges for cross-border transactions.

For Hong Kong SAR specifically, 2020 saw new legislation introduced (the Limited Partnership Fund Ordinance (Cap. 637)), which enables private funds to be registered in the form of limited partnerships in Hong Kong SAR. The regime is intended to attract PE and venture capital funds to set up in Hong Kong SAR to direct capital into corporates. 2020 also saw the implementation of the Inland Revenue Department's electronic service, which allows contracts and instruments of transfer to be e-stamped. The timing of this implementation was fortunate given COVID-19 and the shift to remote working arrangements.

Hong Kong SAR's merger control legislation currently only applies to M&A transactions that involve an undertaking that directly or

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indirectly holds a carrier licence within the meaning of the Telecommunications Ordinance. The Competition Commission is thought to be reviewing the existing framework of its broader anti-competition regime; however, whether the merger regime will expand to other sectors remains to be seen.

Market norms

It is commonly assumed that the Code only applies to companies listed in Hong Kong SAR when in fact it applies to public companies in Hong Kong SAR, which may include unlisted companies. Another common misconception is that there is no merger control regime in Hong Kong SAR. As mentioned above, there is a merger regime, but it currently only applies to the telecommunications and broadcasting sectors.

Hong Kong SAR maintains its own law for M&A transactions that is still closely based on English law (as opposed to the civil law regime that applies in China), which includes connections to the Code. Parties are increasingly using W&I insurance on M&A deals both on the sell-side to execute a clean break and on the buy-side to create a more competitive bid in an auction context. Typically, there are premiums in the range of 1%–2% of the sum insured.

During the COVID-19 period, technology has been key. Organisations have had to ensure that their IT is sufficiently robust to support remote working. Electronic signing platforms such as DocuSign have become more commonly used in transactions. More generally, transaction management platforms are gaining traction, simplifying and automating certain legal processes such as completion checklists, and there continues to be a trend towards using cognitive or artificial intelligence (AI) software for due diligence.

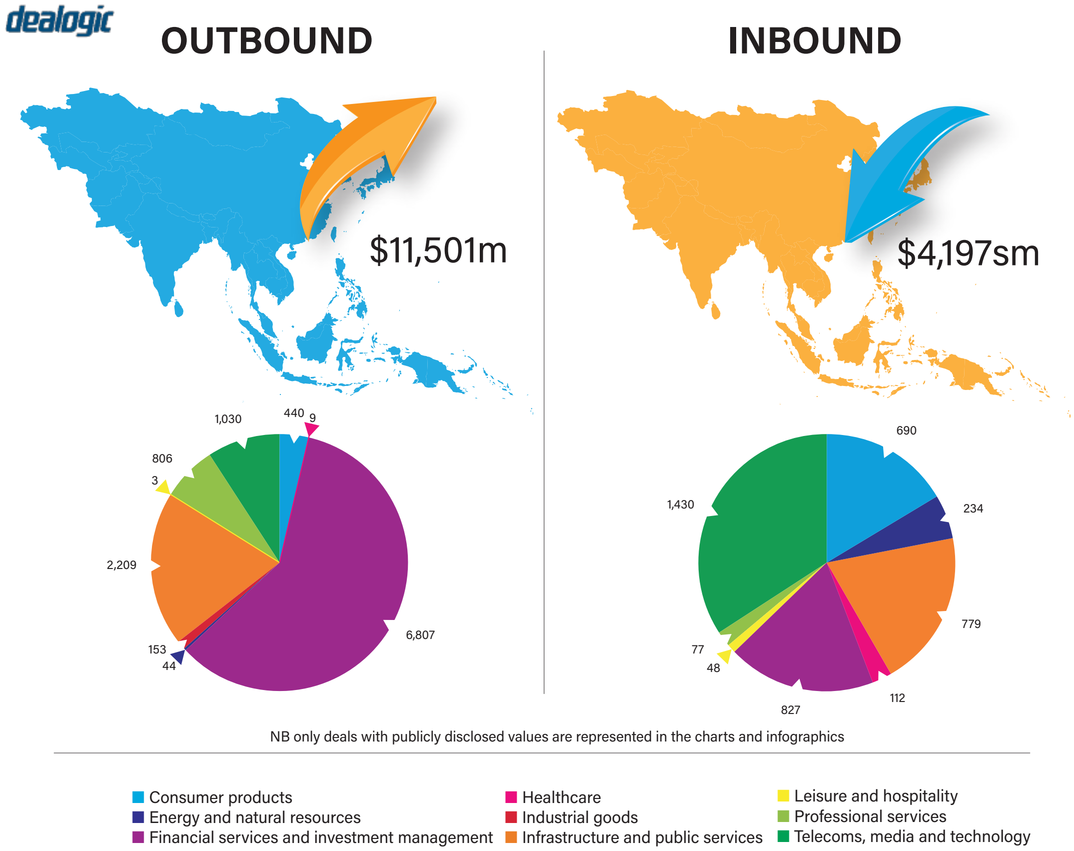
"There has been an increase in outbound activity, with a focus on Chinese target companies"

Public M&A

A takeover of a public company listed in Hong Kong SAR may be executed principally by way of a general offer (mandatory or voluntary) or a scheme of arrangement (SOA). If a takeover offer is made and acceptances are received in respect of 90% or more of the shares to which the offer relates, the offeror may compulsorily acquire the non-accepting shareholders' shares. An SOA requires approval by members representing at least 75% of the voting rights of members present and voting in person or by proxy at the meeting, with not more than 10% of the voting rights attached to all disinterested shares opposed to the scheme.

Most listed companies in Hong Kong SAR have a controlling shareholder that holds more than 30% (and often more than 50%) of the company's shares, making it vital to have the controlling shareholder's support in any attempt to obtain control. As a result, hostile bids, while allowed, virtually never occur.

COVID-19 has not affected public takeover rules in Hong Kong SAR. All conditions to a voluntary general offer or an SOA must be satisfied within the time periods prescribed by the Code. Consequently, many takeovers in Hong Kong SAR are affected by way



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of a pre-conditional offer in which there are mandatory regulatory conditions that cannot (or may not) be satisfied within the prescribed time periods.

Other than the acceptance condition, conditions that are usually attached to a takeover offer include regulatory approvals and various standard no occurrence of MAC or illegality conditions, although the consent of the executive is required to invoke such conditions. No financing conditions are accepted, as the announcement of an offer should include confirmation by the financial advisor that the offeror has sufficient financial resources to satisfy the full offer price.

Break fees in public M&A remain uncommon in Hong Kong SAR, as most deals are consensual and require the controlling shareholder to agree to the deal. The Code provides that an inducement fee or a break fee must be *de minimis* (usually no more than 1% of the offer value). The target's board and financial advisor must confirm to the executive that each of them believes that any agreed fee is in the best interests of the shareholders, and such arrangement must be fully disclosed to all shareholders in the offer announcement.

Private M&A

Consideration mechanisms involving post-completion net debt and/or working capital adjustments based on completion accounts are more prevalent than locked-box structures in M&A transactions in this region, especially in 2020 when buyers saw the need to

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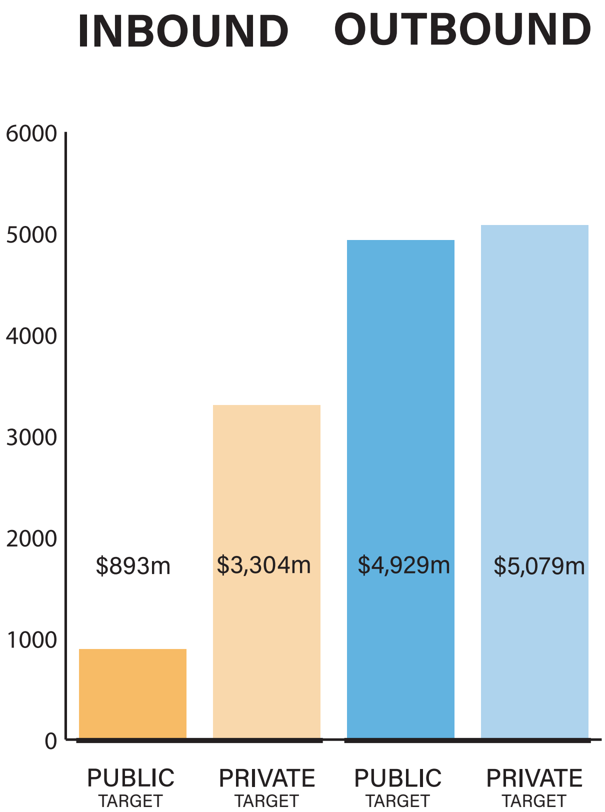

NB: Values may exclude certain transactions, for example asset acquisitions/sales

mitigate market uncertainty caused by COVID-19. For seller-friendly transactions in which targets are being sold in competitive auctions, locked-box structures are still very common.

Earn-out structures do not commonly feature in transactions in this region, largely due to the uncertainties that such structures create for both buyers and sellers. However, earn-out structures are becoming more attractive as parties attempt to work around the difficulties in predicting future performance of the business in this climate. Escrow arrangements are still widely used, particularly when there are financial sponsor sellers who would not typically provide a parent guarantee.

W&I insurance continues to grow in popularity and is now a regular deal tool used to facilitate M&A transactions. While it was initially used by PE sponsors looking to achieve a clean exit, increasingly, parties consider its use as a tool to bridge gaps between liability caps offered by sellers and coverage required by buyers, particularly in PE deals. Insurance underwriters within the region generally view Hong Kong SAR as a relatively stable and low-risk jurisdiction, which has a positive effect on premium levels.

In competitive auctions, sale conditions may be limited to receipt of requisite third-party consents, such as regulatory consents in respect of targets operating in regulated industries and consents required under contractual obligations binding on the vendors and/or target entities. In bilateral transactions, potential buyers generally have more leverage to negotiate additional, bespoke conditions precedent, including MAC clauses, repeated warranties and no-breach conditions.

In M&A transactions involving a Hong Kong SAR target, the transaction documentation is typically governed by Hong Kong SAR law, given that local laws dictate the share transfer and attendant control transfer procedures. For regional M&A

transactions, foreign governing laws sometimes get adopted, for example Singapore law or the laws of England and Wales, and parties increasingly designate Hong Kong SAR or Singapore for arbitration.

In 2020, the HKEX ranked second globally in terms of IPO proceeds, behind the NASDAQ. HKEX's ranking was driven by several secondary listings of high-profile US-listed China-based companies on the HKEX in 2020 and take-privates. The uncertain market has made it more difficult to execute trade sales and sales to financial sponsors, both in Hong Kong SAR and globally, although the market recovered considerably towards the end of 2020.

Looking ahead

Despite the pandemic and continuing geopolitical uncertainty, it is encouraging to see the way the M&A market has rebounded in the second half of 2020 and it is hoped that this rebound will flow through to a stronger 2021, particularly as the vaccine rollout continues.

Hong Kong SAR remains an attractive hub for both inbound and outbound investment, particularly for Chinese companies seeking alternative options due to growing regulatory pressure in the US PE houses still have significant stockpiles of capital that need to be deployed, which should drive deal flow in 2021.

United Kingdom

Nick Cline, Robbie McLaren, Douglas Abernethy and Terry Charalambous,
Latham & Watkins

The UK M&A market in 2020 was significantly down in the first half of the year due to the effects of the COVID-19 pandemic. Deal activity picked up in the second half of the year, as companies navigated their way out of the immediate liquidity crisis.

The use by a private company of a merger with a listed special purpose acquisition company (SPAC) as an exit method and route to the public markets is a growing trend in cross-border deal-making.

Both public and private M&A transactions play an important part in the UK market, with private M&A deals making up a far higher number of UK target M&A deals. Public takeovers have a prescribed process under the City Code on Takeovers and Mergers (the Takeover Code), as administered by the Panel on Takeovers and Mergers, whereas the structure and process of private acquisitions are a matter of negotiation between the buyer and seller.

Among other notable deals, Latham & Watkins advised on NVIDIA's acquisition of Arm for $40 billion, a deal that highlighted the UK's ongoing discussion of national interest and security. Transactions involving overseas entities acquiring UK companies in sensitive sectors will be subject to greater scrutiny following the announcement of the National Security and Investment Bill.

COVID-19 and recovery plans

UK M&A activity overall decreased in 2020 as a result of COVID-19, as companies responded to the challenges arising from the pandemic and focused on strengthening their balance sheets. Despite this backdrop, and the initial shock to businesses in the second quarter, domestic M&A and inbound M&A increased in the third quarter; however, outbound M&A has seen a significant drop each quarter. Real estate, financial services, retail and hospitality have all seen a decrease in M&A activity, while the technology, warehousing and healthcare sectors have been more robust.

Deal activity is expected to continue to increase in the first quarter of 2021, as vaccines are rolled out and companies look to acquisitions to better protect against future challenges or disposals to increase liquidity. However, with the continued uncertainty following Brexit, and the UK government lifelines introduced during COVID-19 coming to an end, the speed of recovery in the first part of 2021 may be dampened.

"In 2020, there was an increase in exits by way of a merger with a SPAC"

The most significant factors influencing deal structures are related to:

- Industry consolidation, M&A-driven growth, financing considerations or other factors;
- Distressed M&A work: takeover reorganisations, bidding, post-M&A closings; and
- The impact of COVID-19 on M&A-related disputes, use of indemnity provisions.

The COVID-19 pandemic has caused companies multiple challenges, the effect of which has been to create a liquidity need for many companies and an increase in refinancings and restructurings (including debt-for-equity swaps). Latham & Watkins has advised on several balance sheet restructuring matters in 2020 in affected sectors including Swissport, New Look, PizzaExpress, and FatFace.

Parties are also seeking to address the allocation of risk in transaction documents. Express references to COVID-19 are being included in conditions precedent (as opposed to attempting to rely on the doctrine of frustration), and earn-outs are becoming more common as buyers seek comfort on a target's financial performance during COVID-19 before paying full value. Warranty and indemnity (W&I) insurers have responded by including broad exclusions for breach of warranty claims resulting from COVID-19.

In 2020, there was an increase in exits by way of a merger with a SPAC (or blank cheque company), which is seen as a more efficient route to the public markets, while also enabling the financial sponsor to participate in any upside in the enlarged structure, as evidenced by Paysafe's merger with Foley Trasimene Acquisition Corp. II, which Latham & Watkins advised Paysafe on.

The market dislocation caused by COVID-19 is encouraging financial investors to revisit old targets and move to execution quickly where assets are now distressed. W&I insurance uptake by financial investors on both the buy-side and sell-side remains a common feature in M&A transactions as they look to bridge the gap, which has also resulted in corporates becoming more familiar with such products to remain competitive (on the buy-side) or to keep a larger portion of the proceeds as free cash (on the sell-side).

We expect UK M&A to continue to recover in 2021 as COVID-19 vaccines are rolled out and the first companies and financial investors emerge from the pandemic seeking to take advantage of M&A opportunities.

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Legislation and policy changes

The Companies Act 2006 applies to public and private companies registered in the UK. While the Companies Act does not govern M&A activity as such, its requirements dictate the way that deals by UK companies are effected.

The acquisition of private companies is a matter of negotiation between the buyer and seller, and no regulated offer process is required. In non-regulated industries (i.e. other than financial services, telecoms, media, pharmaceuticals), deals are not typically subject to input from regulatory bodies, save for competition and foreign direct investment (FDI) matters.

Public acquisitions are governed by the Takeover Code.

The end of the Brexit transition period on December 31 2020 (the transition period) marked the end of the European Commission's status as the 'one-stop shop' for the review of mergers relating to the UK meeting certain monetary thresholds. This means that if a merger satisfies the jurisdictional thresholds of the EU Merger Regulation and the UK's Enterprise Act 2002, the Competition and Markets Authority (CMA) and the European Commission may now conduct parallel assessments of the same merger in their respective jurisdictions. In its 2020–2021 Annual Plan, the CMA estimated that this would result in a 50% increase in the number of merger cases it reviews.

The National Security and Investment Bill was published in November 2020 and is expected to become law this summer (the NSI Regime). The NSI Regime will give far-reaching powers to the UK's Secretary of State for Business, Energy and Industrial Strategy (BEIS) to intervene in relation to transactions that risk national security. The NSI Regime introduces (i) a statutory requirement for parties to notify relevant transactions in the most sensitive areas of the economy; and (ii) a 'call-in' power that enables BEIS to assess other transactions that may give rise to national security risks.

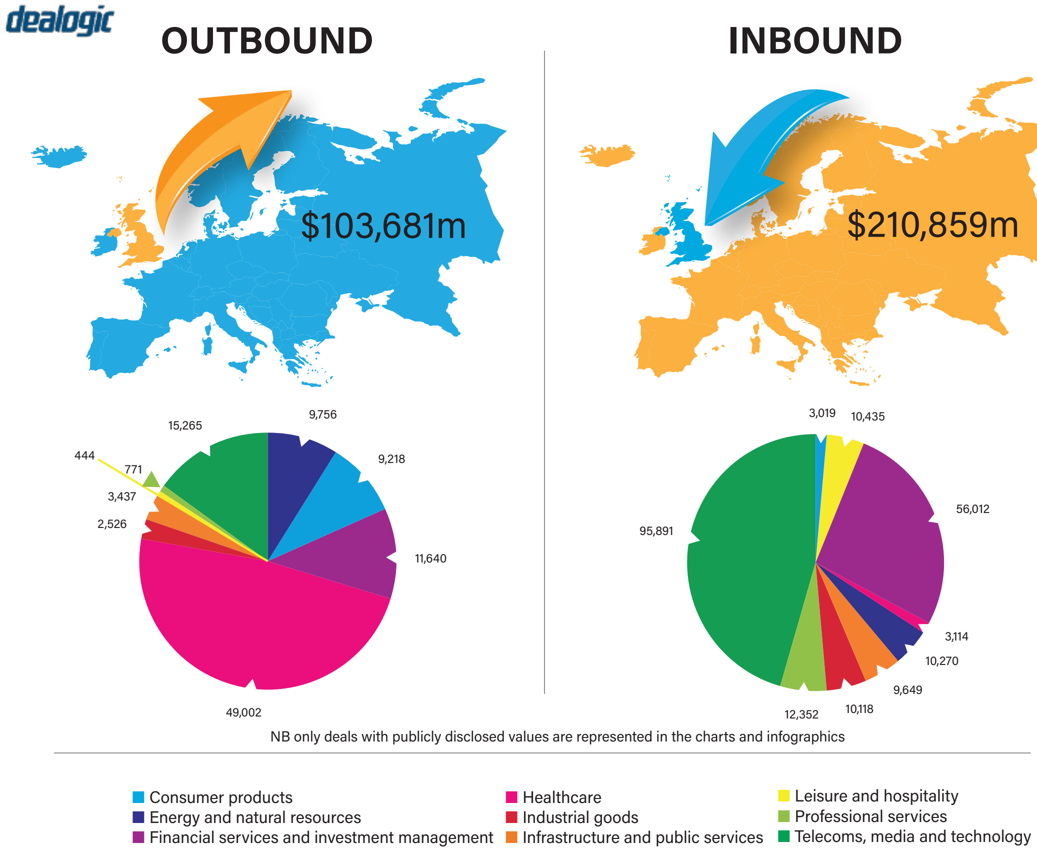
The Pensions Regulator will gain enhanced powers in 2021. Unlike the NSI Regime, the Pension Schemes Act will not have retrospective effect, however, it expands the circumstances in which the Pensions Regulator can exercise existing moral hazard powers. The Pension Schemes Act also creates new moral hazard powers that can be exercised against any 'person' and includes penalties that encompass criminal sanctions. Given increasing political and public pressure on the Pensions Regulator, dealmakers should anticipate increased scrutiny of deals that involve a defined benefit pension plan.

As of April 2021, a dedicated Digital Markets Unit (DMU) will be set up within the CMA that will introduce and enforce a new code to govern the behaviour of platforms that have considerable market power — known as 'strategic market status'.

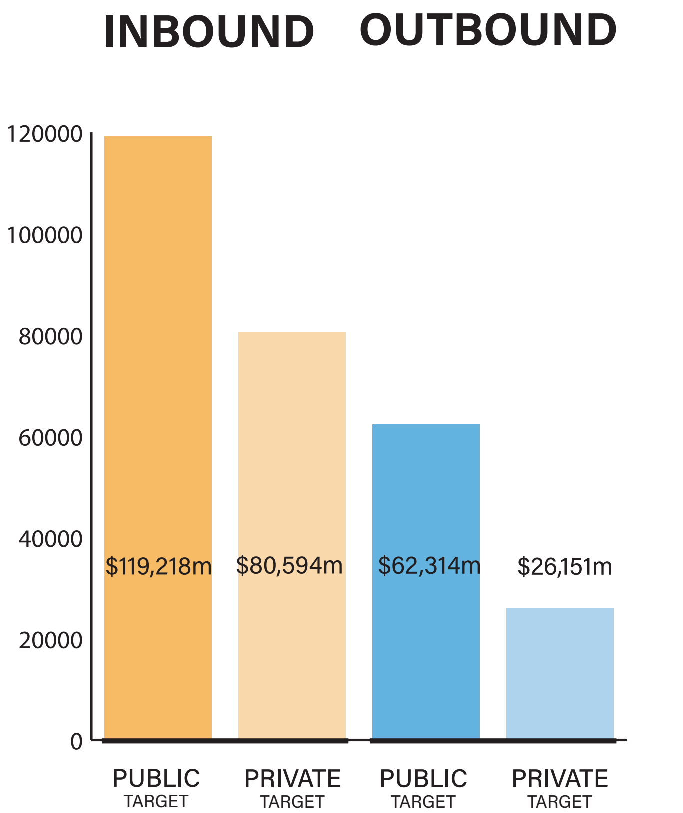
Under the new code, platforms including those funded by digital advertising could be required to be more transparent about the services they provide and how they are using consumers' data. The platforms would also be required to give consumers a choice over whether to receive personalised advertising, and would be prevented from placing restrictions on their customers that make it hard for them to use rival platforms. Moreover, the DMU is expected to introduce greater scrutiny of M&A involving firms with strategic market status.

Market norms

UK companies can be acquired by way of a share purchase (i.e. purchasing all the shares of the target company) or an asset purchase (i.e. purchasing all the assets of the target company) but, as a matter of UK domestic law, M&A transactions between private UK companies cannot be consummated by way of a merger by absorption. The Companies Act does provide for mergers for UK public companies, but these provisions are generally not used and a scheme of



NB only deals with publicly disclosed values are represented in the charts and infographics



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arrangement is more commonly seen. This is in contrast to other jurisdictions where mergers are frequently encountered.

The UK merger control regime is voluntary, and there is no obligation for the notification of mergers in the UK, although, in practice, notifications are made to avoid any interim enforcement orders that might create deal uncertainty or delay.

An area that is often overlooked by parties involved in M&A transactions is that buyers do not usually attend to consolidation of group companies immediately after closing, resulting in continued administrative and financial burdens (e.g. filing annual accounts) to maintain dormant or inactive subsidiaries.

There is an increasing use of artificial intelligence (AI) technology to conduct more efficient due diligence in M&A transactions. Dealmakers have also made extensive use of virtual meeting technology and electronic signature platforms to negotiate and close transactions during the pandemic.

Public M&A

A bidder may choose to stake-build in order to obtain control of a public company, however, depending on the time of such acquisition and form of consideration, doing so may set a floor price and fix the form of consideration for any future offer. Furthermore, acquiring 30% of the voting rights in a public company will require a bidder to launch a mandatory cash offer for the remainder of the shares it does not own.

In addition, any dealing giving rise to speculation, rumour or an untoward movement in the public company's share price may mean an

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> ***"The market dislocation caused by COVID-19 is encouraging financial investors to revisit old targets and move to execution quickly..."***

announcement is required (if the acquirer is considering making an offer for the whole company), while disclosures will also be necessary once certain thresholds of ownership are crossed.

A takeover offer will usually be subject to an extensive set of conditions, including: securing acceptances carrying more than 50% of the voting rights in the target (or, in the case of a court-sanctioned scheme of arrangement, the requisite 75% target shareholder approval), antitrust and regulatory approvals, bidder's shareholder approvals, listing of consideration shares (when applicable), and conditions dealing with the state of the target's business.

A bid cannot be subject to conditions that depend on the subjective judgment of the bidder. Additionally, seeking to rely on a material adverse effect (MAE) or similar bidder protective condition to not proceed with an offer requires the consent of the Takeover Panel, which applies a materiality test with a high bar (requiring the circumstances to be of considerable significance and aiming to strike at the heart of the purpose of the transaction) before it will permit an offer to be lapsed.

In 2020, the Takeover Panel effectively confirmed that it would not make COVID-related exceptions to its general approach to MAE conditions when it declined to permit the bidder for Moss Bros to rely on an MAE condition on the basis of the impact of COVID-19 on Moss Bros' business. It is possible that we will see a move by bidders towards more tailored conditions aimed at events like the pandemic, which the Takeover Panel has indicated are more likely to be exercisable (assuming the relevant situation arises) than would be the case if the bidder were seeking to rely on a general MAE condition.

Occasionally, a bidder will announce a firm intention to bid on a pre-conditional basis, when posting of the bid document is suspended pending satisfaction of stated pre-conditions, often material antitrust conditions if it is anticipated that these will involve protracted processes.

In public takeover offers, break fees (when the target pays the prospective buyer) are now largely prohibited, whereas reverse break fees (when the prospective buyer pays the target) are not prohibited. Only in limited circumstances can a break fee be offered, for example, a break fee may be offered to a 'white knight' making a bid in competition with a hostile offer that has already been announced (subject to such fee being *de minimis* and payable only upon the first offer becoming or declared wholly unconditional).

If the bidder is a UK public company and subject to the UK Listing Rules, and the total value of the reverse break fee exceeds 1% of the market capitalisation of the bidder, the bidder's directors will need to treat the reverse break fee as a material transaction (which, among other things, requires shareholder approval). If the bidder controls more than 10% of the target, a reverse break fee may also constitute a related party transaction for the purposes of the UK Listing Rules.

Private M&A

According to the Latham & Watkins 2020 Private M&A Market Study (the Study), which examined over 260 deals signed between July 2018 and June 2020, 47% of deals included a locked-box mechanism, 25% of deals included a completion accounts mechanism and 28% of deals did not provide for price adjustment. This trend is consistent with results from the previous four editions of the study and reflects the continuing seller-friendly nature of the UK M&A market. The number of deals that featured an earn-out remained limited at 18% (albeit an increase of 4% from the previous study).

The Study also revealed the continued limited use of escrows in private M&A deals (19% of deals surveyed, a third successive year of escrows featuring in 20% or less of deals), and a steady use of W&I insurance (34% of deals).

In private M&A, the conditions to closing that are included in a purchase agreement will vary based on the circumstances of each transaction. Historically, conditionality beyond regulatory and anti-trust clearances is uncommon, but the increasing role of regulation in deal making and the impact of COVID-19 could change this.

According to the Study, only 10% of deals included a material adverse change clause (which refers to events that have a negative impact on the market generally or, more specifically, on the target company's business). The use of breach of covenant/warranty conditions remains very limited (8%), but we are seeing an increase in the use of FDI conditions (11%).

Purchase agreements relating to UK companies and assets are typically governed by English law and are subject to the jurisdiction of the English courts. For global transactions, depending on the location of the parties and their advisers, purchase agreements are frequently governed by English law (since it is viewed as stable, impartial and commercial, with a developed litigation infrastructure) but may alternatively be subject to the laws and courts of another jurisdiction, such as New York.

The market for exits remains resilient, with sellers seeking an IPO (or merger with a SPAC) or sale to realise their investment; in some instances, sellers employ dual-track or triple-track exits to give greater certainty that an exit will occur.

Looking ahead

We expect UK M&A activity to continue to increase in 2021. However, remaining uncertain following the end of the Transition Period and the continuing impact of COVID-19 mean that the speed of recovery is likely to be slower in the first part of 2021.

We expect the market to continue to be 'seller friendly', with sellers seeking greater certainty as to a buyer's financial ability and covenant strength. We are also likely to see an increase in the use of earn-outs and escrows as buyers seek comfort on the financial performance of a target during COVID-19.

United States

Robert Katz, Allison Eitman, Bharath Mohan and Karen Song,
Latham & Watkins

The US M&A market is recovering from a roller-coaster year due to the COVID-19 pandemic. The onset of the pandemic in early 2020 caused a slowdown in deal activity, but the recovery in the second half of 2020 set the stage for a continued increase in deal activity into 2021.

Representation and warranty insurance (RWI), increasingly common in private M&A transactions, has adapted to the changing M&A landscape by accounting for pandemic-specific risks. RWI brokers are also emphasising the availability of particular policies, such as contingent liability policies, that may apply outside the M&A context.

The scope of cross-border transactions subject to governmental review has increased. In February 2020, the Committee on Foreign Investment in the United States (CFIUS) implemented a set of rules that expanded CFIUS's jurisdiction and mandated filings in the case of investments in certain specified critical technologies.

The market continues to be driven by both private and public M&A transactions, although private M&A is more prevalent because there are many more private companies than public companies. Ready availability of financing is a driving factor, particularly for private company and private equity (PE) deal-making, for which acquirer stock is not available as transaction consideration.

Several recent transactions highlight the importance of considering how certain measures taken in response to COVID-19 could be interpreted (or provide a basis for termination) under transaction agreements, including in transactions in which a target does not suffer a material adverse effect (MAE). For example, in May 2020, L Brands and PE firm Sycamore Partners agreed to terminate their agreement under which Sycamore Partners would have acquired L Brands' majority stake in Victoria's Secret. Prior to the termination, Sycamore alleged that by taking certain actions in response to COVID-19 (e.g. furloughing a large number of employees), L Brands breached its obligation to operate the business 'in the ordinary course consistent with past practice'.

In November 2020, the Delaware Court of Chancery held in *AB Stable VIII LLC v. Maps Hotels and Resorts One LLC et al.* that the seller breached its covenant to operate the target business 'in the ordinary course of business consistent with past practice' by taking various actions in response to COVID-19. The court determined that COVID-related economic effects did not constitute an MAE of the target, particularly as those effects fell within a 'calamities' exception to the MAE definition.

"More deal parties adjust their transaction structures and use COVID-specific terms and conditions to allocate pandemic-related risks"

LATHAM & WATKINS LLP

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COVID-19 and recovery plans

COVID-19 caused a sharp decline in deal volume and deal value in the first half of 2020. Even with a strong rebound in the second half of 2020, M&A activity still ended down 21% by value compared to 2019, according to *Mergermarket*. Despite the challenges faced by the M&A market in 2020, deal activity is expected to accelerate in 2021.

More deal parties adjust their transaction structures and use COVID-specific terms and conditions to allocate pandemic-related risks, including through the use of contingent pricing structures and carveouts in MAE definitions and interim operating covenants to permit targets to take actions in response to COVID-19.

The frequency of distressed asset sales increased (and is expected to remain at elevated levels) in industries that have been severely negatively impacted by COVID-19, such as the transportation, lodging, hospitality, and live entertainment industries.

In 2020, there was a dramatic surge in the volume and size of special purpose acquisition company (SPAC) deals, an alternative path to taking a private company public whereby a SPAC is formed to raise cash in an IPO, and the proceeds are subsequently used to complete a business combination with a private target, typically within two years of the SPAC's IPO.

Private equity firms remain a driving force of deal-making. Despite COVID-19, uncommitted capital at PE firms remains at record levels, which can be expected to continue to drive M&A activity in 2021 as firms look to deploy that capital.

Legislation and policy changes

US M&A transactions are subject to regulation by both the federal government and the target's state of incorporation.

The federal government primarily regulates the issuance and sales of securities through the Securities and Exchange Commission (SEC), antitrust matters through the Federal Trade Commission (FTC) and the Antitrust Division of the Department of Justice (DOJ), and foreign

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About the author
Robert Katz regularly represents financial institutions, public companies, and private equity sponsors and their financial advisors in their highest-stakes M&A transactions. His practice includes cross-border transactions, governance matters, joint ventures, leveraged buyouts, public and private acquisitions and divestitures, spin-offs, takeover and activist defence strategies, and tender and exchange offers.

Robert, a nationally recognised corporate lawyer, helps clients navigate both negotiated and unsolicited M&A transactions across geographies and industries, including industrials, healthcare, technology, and media and communications.

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Allison Eitman is a corporate associate in the New York office of Latham & Watkins and a member of the M&A practice.

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Allison's experience also includes representing boards of directors and special committees in connection with corporate governance and shareholder activism matters.

investment that may have national security implications through CFIUS. The laws, rules and regulations administered by the SEC are particularly relevant in the purchase or sale of a US public company. The laws of the target's state of incorporation govern that company's internal affairs and impose requirements for shareholder approval of mergers and the procedures for effecting mergers.

In June 2020, the FTC and DOJ issued the final Vertical Merger Guidelines (Guidelines). Unlike the draft version, which proposed a safe harbour if the parties to the vertical merger had less than a 20% share of the relevant market, the final Guidelines do not include a safe harbour based on either party's market share. It remains unclear whether behavioural remedies will be acceptable to resolve issues in future vertical mergers and whether the Guidelines will remain in effect under the Biden administration.

The Biden administration has indicated that it expects to adopt policies and pursue legislation that could significantly impact M&A in certain sectors of the economy (e.g. increasing federal infrastructure spending and adopting laws or regulations to address climate change). Several states have adopted legislation limiting the amount of energy that can be used or generated by fossil fuels, which should continue to encourage renewables investments.

Market norms

Unlike the 'locked-box' approach that is more common in many non-US jurisdictions, in most US private acquisitions, the purchase price agreed to at signing is usually subject to closing or post-closing adjustment based on the amounts of certain financial accounts of the target (e.g. cash, indebtedness and net working capital) on the closing date. Under this approach, the parties generally must spend more time negotiating the adjustment mechanisms and related accounting methodologies.

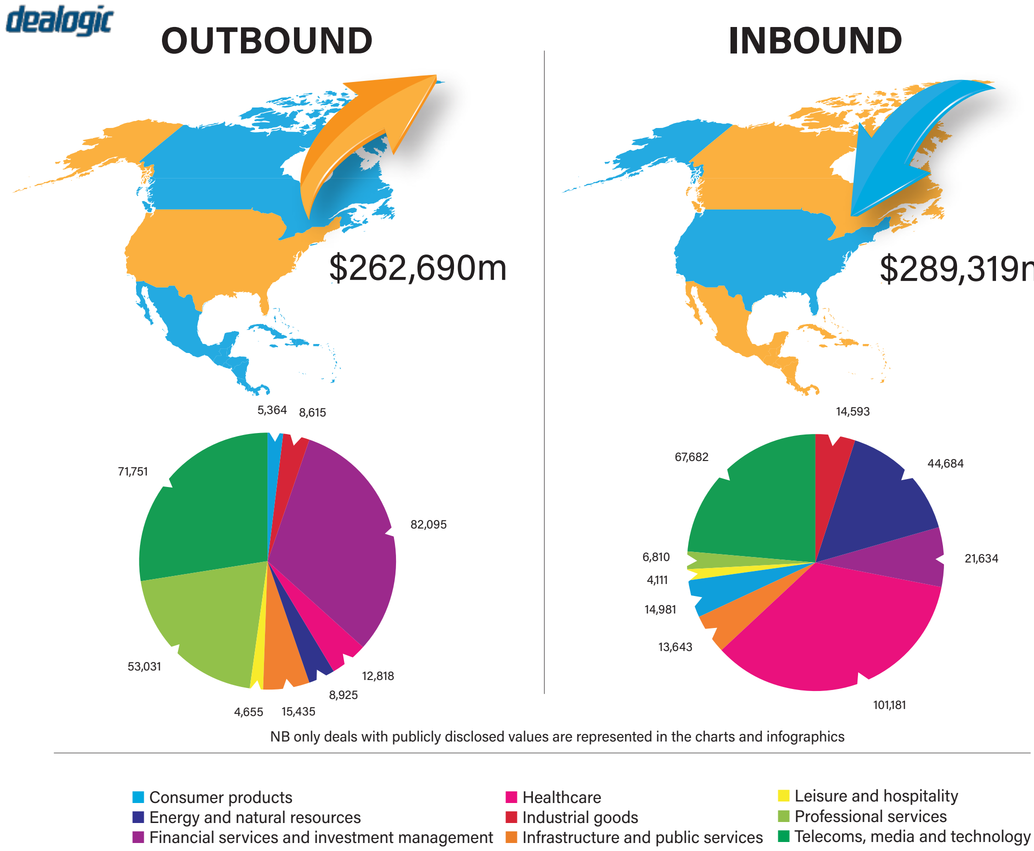
Under the laws of most states, public target boards must generally retain the right (commonly referred to as a 'fiduciary out') to terminate the transaction agreement after signing but before the target's shareholders approve the transaction to accept a higher offer. Shareholder litigation is common in such transactions, and the buyer is generally liable for related costs.

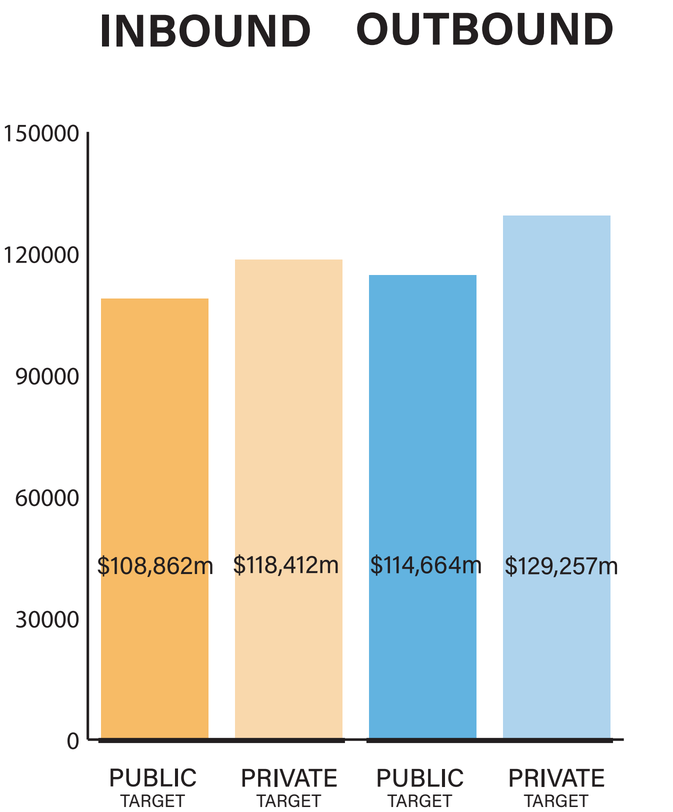
RWI and transaction structures that provide for no post-closing recourse by the buyer against the seller except for fraud are increasingly common in private company transactions.

As a result of the pandemic, dealmakers have had to adjust to a virtual environment in which almost every aspect of an M&A transaction relies on technology, necessitating a keener focus on cybersecurity issues in the deal execution process. Also, data privacy and cybersecurity have become critical elements of the business and operations of most companies and thus should be a key focus of due diligence in any M&A transaction.

Public M&A

In light of the fiduciary duties of public company directors that generally require them to maximise shareholder value in a sale, target boards often conduct some form of a pre-signing market check.





NB: Values may exclude certain transactions, for example asset acquisitions/sales

However, in some deals the target board will forego a pre-signing market check in exchange for a 'go shop' right to solicit competing offers for a limited period of time (usually 30–60 days) after signing the transaction agreement.

While state law generally requires target boards to preserve a 'fiduciary out' to accept a higher offer under certain circumstances, buyers usually negotiate for a prohibition on the target's right to affirmatively solicit competing offers (except in the case of a 'go shop' right), and the right to receive a 'break-up' fee if the target's board terminates the transaction agreement to accept a higher offer.

Most states require shareholder approval (usually by a majority of outstanding shares) of most mergers. Certain regulatory approvals, including clearance under the Hart-Scott-Rodino antitrust statute, and for non- US acquirers, from CFIUS, must be obtained before an acquirer can take control of a US company. Acquiring a US company in regulated industries such as financial services and energy may be subject to additional regulatory scrutiny at the federal and/or state level.

The acquisition of a US public company can be structured either as a one-step merger between the acquirer (or more commonly a subsidiary of the acquirer) and the target (typically requiring majority shareholder approval), or a two-step transaction involving a tender or exchange offer by the acquirer for all of the target's outstanding shares followed by a back-end merger. Both types of transactions are typically subject to the following conditions (among others):

- Accuracy of representations and warranties;
- Material compliance with covenants;
- No MAE on the target; and
- Receipt of regulatory approvals.

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Bharath Mohan is an associate in the New York office of Latham & Watkins. Prior to joining Latham full time, he was a summer associate at the firm. He works within the firm's M&A department.

Bharath earned his JD from Duke University School of Law, where he graduated *magna cum laude* and served as articles editor for the Duke Journal of Gender Law and Policy. Earlier, he earned his BA from Dartmouth College, where he graduated *cum laude*.

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Karen holds a degree from the University of International Business and Economics in China, and a LLM from Harvard Law School.

"In 2020, there was a dramatic surge in the volume and size of SPAC deals"

Nearly all public target M&A deals in 2020 included an MAE exception for changes, effects or conditions arising out of the COVID-19 pandemic and governmental responses thereto, according to *Deal Point Data*. Many agreements also provide for greater flexibility under the interim operating covenants to permit the target to take action in response to COVID-19.

Public company merger agreements generally require the target to pay a termination fee if the target terminates the agreement to accept a superior offer, or if the buyer terminates because the target changes its recommendation in favour of the deal. These fees usually comprise 2% to 4% of the transaction's equity or enterprise value, but can vary based on deal size and other factors.

In some transactions, the buyer is required to pay the seller or the target a reverse termination fee under certain circumstances (for example, the failure to obtain required regulatory approvals, or the failure to close the transaction even if all the buyer's closing conditions are satisfied). These fees are highly variable but often range between 5% and 7% of the transaction's equity or enterprise value.

Private M&A

There was an increased use of earn-outs in 2020, under which the seller will receive one or more additional payments, contingent on the target's future performance, in part to account for increased earnings uncertainty due to COVID-19.

Completion accounts (known as working capital or balance sheet adjustments in the US) are common in US private company acquisitions. Locked-box transaction structures are much less prevalent in private company acquisitions in the US than in many other jurisdictions.

At the beginning of the pandemic, RWI carriers started including broad COVID-related exclusions in their policies. These exclusions have been narrowed to focus on the target's COVID-related risks.

All the conditions listed above for a public M&A (see the bullet points above), except the minimum tender condition, generally also apply in private M&A transactions. However, in the absence of RWI, representations and warranties usually survive the closing in private M&A transactions and may give rise to post-closing indemnity claims.

Merger and share purchase agreements are typically governed by the law of the target company's state of incorporation. If a target company is incorporated in a state with sparsely developed corporate law, the parties sometimes provide that Delaware law will govern certain issues.

The exit environment in the US remains robust, and was substantially boosted in 2020 by so-called 'de-SPAC' transactions, i.e. mergers between SPACs and private companies. PE firms recorded 952 exits in 2020 (a 14% decrease compared to 2019), with a combined value of $378.3 billion (a 6% increase compared to 2019), according to *Pitchbook*. Public listings (consisting of traditional IPOs and de-SPAC transactions) comprised eight of the 10 largest exits.

Looking ahead

There is growing confidence in the market that M&A activity in the US will return to, or even surpass, pre-COVID-19 levels in 2021.

Among the factors likely to drive and sustain M&A activity in the near-term are pent-up demand from the M&A slowdown during the first half of 2020, greater political certainty following the presidential election, continuing low interest rates, and the general availability of credit. Moreover, the amount of capital to be invested by PE firms, the Biden administration's likely support for infrastructure and renewables investment, the gradual recovery of oil prices, and the continuing popularity of de-SPAC transactions will also help create a positive environment for increased deal flow.

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