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M&A monitor

Q4 2021

US drives global dealmaking to all-time high

Freshfields Bruckhaus Deringer

2021 breaks new records for deal value

Welcome to our final M&A monitor of 2021, in which we take a deep dive into global deal data across the year and pinpoint the issues we expect to shape transactional activity through 2022 and beyond.

The most eye-catching number of the year is the aggregate figure for global M&A by value, which had hit $5.5tn by early December, 8 percent higher the previous *annual* record of $5.13tn with three weeks of the year still to run. Deal volumes were up on 2020 but not by much, meaning the value of the average M&A transaction globally topped $100m for the first time, a rise of more than 36 percent year-on-year.

The numbers are remarkable given the factors dragging on deals, from rising interest rates to tougher antitrust scrutiny on both sides of the Atlantic (see article on page 8 for more detail). However, these challenges are currently outweighed by incentives, not least the continued availability of cheap financing and the fact the equity markets are favoring deal activity. The stock prices of companies that have completed a deal this year are outperforming those of companies that haven't by more than 2 percent, according to a recent study.

M&A value is up in every industry across the year, with industrials and materials and real estate (+59 percent) showing the biggest rise. Real estate is perhaps the most surprising success story amid a global health crisis that has kept millions away from work; activity in the sector bounced back strongly from a subdued 2020, pushing the value of the average real estate deal this year almost 80 percent higher to $157m.

M&A in 2021 broke all previous records, driven by strong dealmaking activity in the United States.

US fuels outsize M&A growth

North America remains the primary driver of M&A, with regional deal value up 61 percent to $2.7tn by early December – almost half the global total. US transactions comprise the bulk of this activity, with more than $2tn of domestic US deals and almost $450bn of inbound investment into the United States across the year as a whole.

US buyers were behind more than $680bn of outbound transactions, with the UK the most popular market for the fourth consecutive year. US buyers continue to find UK assets attractive thanks to UK equity prices remaining low post-Brexit, with the price–earnings gap between UK public companies and those in other leading economies as wide as it's been in 20 years.

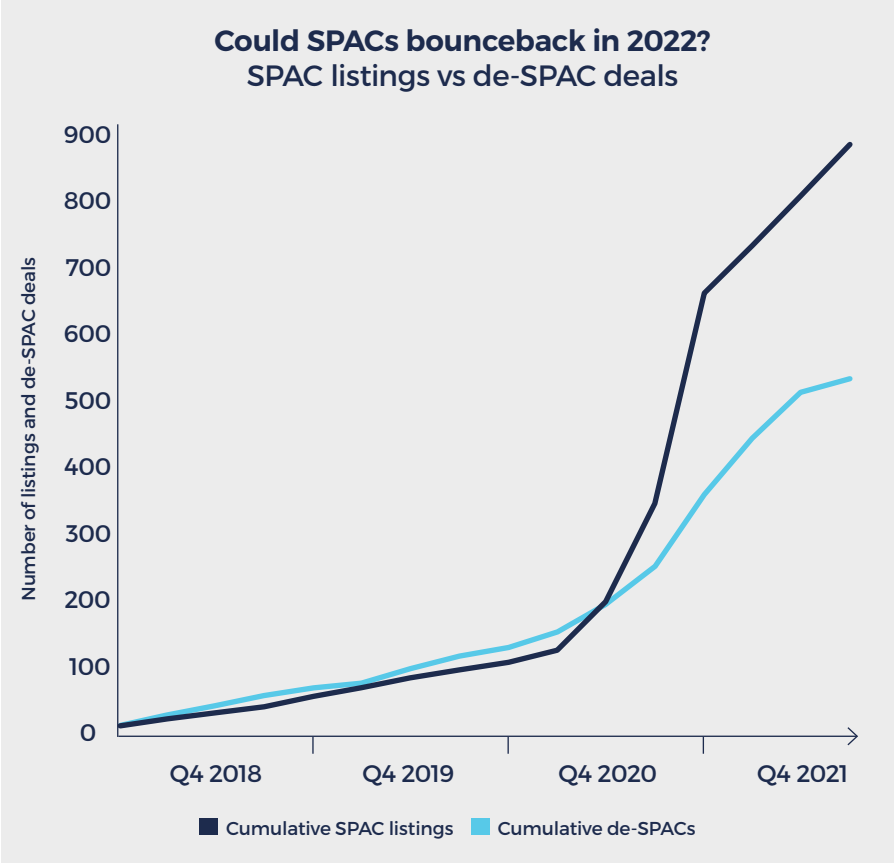
Globally, the biggest uptick in outbound US M&A activity by value involved assets in the consumer (+122 percent) and industrials sectors (+117 percent), while at a country level there was strong interest from US buyers in Israeli tech companies. Inbound investors to the United States heavily targeted real estate (+119 percent by value) and industrials (+93 percent), while there was also a big uptick in infrastructure (+114 percent), although this is skewed by Canadian Pacific Railway's $31bn acquisition of Kansas City Southern.

Deal value in the US infrastructure sector more than doubled across the year, although this number is skewed by Canadian Pacific Railway's $31bn acquisition of Kansas City Southern.

> There are still several hundred SPACs searching for targets and we're seeing SPAC founders deploy some creative thinking to fill the PIPE void.

Looking ahead to 2022, it will be interesting to see whether de-SPAC deals (still primarily a US phenomenon) rebound following their recent slump, which has been driven by tougher SEC scrutiny and a contraction in the availability of PIPE investment (a source of capital that has long been critical to the de-SPAC process), among other things. There are still several hundred SPACs searching for targets, and as this piece explains, we're seeing SPAC founders deploy some creative thinking to fill the PIPE void. With London attracting its first SPAC following Lord Hill's UK listing review and further SPAC IPOs in other markets, we're likely to see more SPAC-driven activity in Europe next year.

Elsewhere (albeit from a lower base), M&A in LatAm and the Middle East and Africa also surged in 2021, more than doubling to $129bn and $213bn, respectively. In terms of global cross-border activity, there were significant increases in foreign buyouts of Asian financial assets and European healthcare and industrials companies.



Source: Refinitiv (data correct to 24 November 2021)

Asia Pacific data shows influence of China

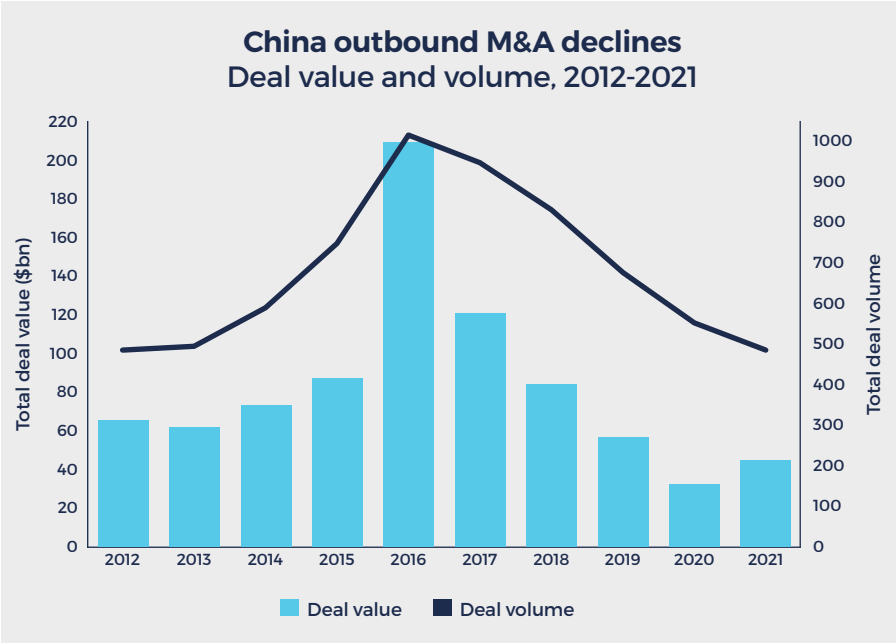
> Outbound Chinese M&A by value over the past two years is at its lowest level in a decade.

By contrast to North America, activity in Asia was more muted in 2021, growing by 18 percent year-on-year. Breaking down the data by country shows the influence of China on the numbers, with outbound Chinese M&A by value over the past two years at its lowest level in a decade.

Alongside the challenges for Chinese corporates in navigating increasingly tough foreign investment regimes around the world, there are domestic factors at play, too, not least that China is preparing for the all-important 20th Party Plenary Congress next year.

In 2021, Beijing announced its 14th five-year plan, with the government pursuing a goal of "common prosperity." The strategy has seen a regulatory crackdown on a number of business sectors (in particular tech platforms) and a drive to protect consumers, with the plan calling for more regulation and enforcement in areas vital to the lives of Chinese citizens, including food, healthcare, financial services, education and personal data protection.

The reforms are part of a long-term plan to boost domestic consumption and reduce China's reliance on exports, foreign technology supply chains and



Source: Refinitiv (data correct to 9 December 2021)

> Buyers entering China are engaging in more forward-looking regulatory due diligence and putting greater emphasis on deal terms that cover regulatory conditionality.

overseas capital markets. In response inbound investment has taken a hit, with asset values falling in several sectors subject to tougher regulatory restrictions , including online education, fintech, gaming and real estate. Increased compliance costs relating to new rules around personal data, AI and algorithms are also affecting tech deals. Buyers entering the market are engaging in more forward-looking regulatory due diligence and putting greater emphasis on deal terms that cover regulatory conditionality. Parties are increasingly going beyond a general interpretation of reasonable or best endeavors to more prescriptive drafting that spells out the expectations on both sides, while requests for break fees and walk-away rights are growing.

PRC issuers, particularly in the technology space, have long opted to IPO in New York, but rising US/China tensions (alongside China's proposed cyber security review of overseas listing applicants) are leading more domestic companies to seek a listing in Hong Kong. From an M&A perspective, this is driving investors (particularly financial sponsors) to reevaluate their entry and exit strategies when investing in Chinese companies. With the Hong Kong Stock Exchange's eligibility requirements more stringent than the NYSE's, investors are front-loading the type of analysis that would typically be done later in the life cycle of an investment as they look to mitigate potential issues that could derail an IPO.

Rising US/China tensions (alongside China's proposed cyber security review of overseas listing applicants) are leading more domestic companies to seek a listing in Hong Kong.

Against this backdrop, India has sought to position itself as a more favorable destination for foreign acquirers, with a series of measures aimed at increasing FDI in infrastructure and other assets. Narendra Modi's government has also implemented restrictions on inbound Chinese investment. However, the recent spate of "unicorn" IPOs in India could set difficult valuation benchmarks in the M&A space.

A recently commenced SPAC regime in Singapore and an upcoming one in Hong Kong could provide regional de-SPAC M&A impetus in 2022 given the difficulties faced by Chinese targets seeking to become listed in the United States.

Ransomware gangs target corporate deals

Cyber security has become an increasingly important element of M&A due diligence given the risks inherent in acquiring and integrating a compromised target. But recently the FBI drew attention to another cyber threat stalking dealmakers – that of well-resourced ransomware gangs using material non-public information (such as details of an imminent corporate transaction) as a lever to launch an attack.

Cyber criminals are more sophisticated and powerful than ever – so much so that researchers claim they are now rich enough to outbid some states for so-called "zero-day" flaws. These are secret vulnerabilities, often brokered by third parties, through which attackers can enter corporate systems and look for the most effective moment to strike. Upcoming M&A transactions are one such event, with the FBI warning that gangs are using inside knowledge of deals to pressure businesses into meeting their demands.

To counter the threat, companies should double down on efforts to ensure information on key events is available only to a small number of individuals, and to implement technical controls that limit access further. Sensitive information should be concealed with code words and encryption and stored in locations not obvious to a criminal crawling through the system (i.e. no "M&A" folders). It's also good practice to develop a material event strategy that sets out how to handle the public release of information relating to transactional or filing details. This should prepare executives to handle the necessary communications, make any regulatory filings on an expedited basis and understand the red lines that might lead the business to consider paying a ransom.

> "It's good practice to develop a material event strategy that sets out how to handle the public release of deal information or filing details.

The FBI has revealed ransomware gangs are using material nonpublic information – such as details of imminent M&A deals – as a lever to launch an attack.

Antitrust outlook for the year ahead

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Antitrust will remain in the spotlight heading into 2022. It has become increasingly clear that the evolving regulatory climate in the United States and Europe requires companies and dealmakers evaluating M&A and strategic plans to consider seriously the potential antitrust implications. Calls for increased antitrust scrutiny mean that even transactions that historically would have seemed straightforward from a competition law perspective require careful planning today. This is especially true for deals in sectors that have drawn increased regulatory focus in recent years, including agriculture, consumer finance, healthcare, technology and transportation.

President Biden has directed the Department of Justice (DOJ) and the Federal Trade Commission (FTC) to enforce the antitrust laws with "vigor" and has appointed new agency leadership committed to reinvigorating antitrust enforcement. We have already witnessed important changes to how the antitrust authorities are reviewing transactions, including an increase in in-depth merger reviews that investigate a much broader range of competition issues. Against this backdrop, however, we also are seeing record levels of M&A activity and HSR filings to the DOJ and FTC, and transactions that continue to be completed with the right preparation and planning.

To successfully navigate the challenges of the new regulatory landscape, boards should focus on three areas.

1. Plan for longer timelines and non-traditional questions in merger review

The new DOJ and FTC have signaled they will scrutinize transactions more closely and evaluate a broader range of competitive harms from M&A. Investigations may include questions seeking to test non-traditional antitrust concerns, including, for example, a transaction's impact on labor markets or data privacy as an aspect of competition. Boards and dealmakers should anticipate that the antitrust authorities are more likely to initiate in-depth investigations that will take longer to complete given the range of issues subject to review. The risk of longer reviews is compounded by the fact that the US agencies are seeing a record number of merger filings and face internal staff and other resource constraints.

Companies should account for lengthier antitrust review periods when calculating the overall deal timeline and be prepared to quickly address issues that do not fall squarely within traditional theories of antitrust harm.

2. Consider resolving competition concerns prior to starting the regulatory process

Heightened antitrust scrutiny also increases the risk that companies and the antitrust authorities will be unable to agree on an acceptable remedy to resolve competition issues. The antitrust authorities, and in particular the FTC, have signaled that past remedies often did not adequately address antitrust concerns and that a higher bar must be applied when evaluating remedy proposals and potential divestiture buyers. The FTC also recently announced that it will include conditions as part of certain settlements that would give the agency increased authority to prohibit future transactions by the companies in the same or related industries. The prior approval requirement also would extend to divestiture buyers in future transactions. Together these changes may make the cost of settlements higher and less attractive. Boards and dealmakers should consider whether it makes sense strategically to proactively resolve obvious competition issues before entering into the regulatory process to narrow the scope of disputes with the regulators about competitive impact.

3. Maintain a credible litigation threat throughout the merger review process

A key feature of the M&A review process in the United States is that the DOJ and FTC cannot unilaterally block a transaction based on their own determination about its competitive implications. Instead, the antitrust authorities must challenge the transaction in federal district court to obtain an injunction preventing closing. As the DOJ and FTC scrutinize transactions more closely, conduct longer investigations, and consider novel theories of harm that have limited or no precedent in the case law, it will be increasingly important for companies to signal that they have the time and the resources to successfully litigate a merger challenge. Doing so may make the regulators think twice about pursuing a case at the margins of the antitrust laws.

Key takeaways for boards

1

New leadership at the DOJ and FTC have promised to increase their scrutiny of transactions while at the same time the agencies are receiving a record number of premerger filings and are facing significant staff and resource constraints. Boards and dealmakers should allow for longer review periods and be prepared for non-traditional questions and theories of harm from the antitrust authorities.

2

The changing regulatory landscape means that the antitrust authorities may place a higher bar on what remedies are sufficient to address their concerns. To narrow the scope of disputes with the DOJ or FTC, boards and dealmakers should consider proactively resolving obvious competition issues outside the regulatory process.

3

In light of calls by the DOJ and FTC to increase antitrust enforcement, boards and dealmakers should signal that they have the time and resources to successfully litigate a merger challenge. Maintaining a credible litigation threat will incentivize the DOJ and FTC to not unnecessarily prolong their investigations and to seriously consider remedy proposals.

This article is taken from our 2022 Board Memo, which rounds up key trends for boards of directors of US public companies over the year ahead. To read the full report, go to Freshfields.us/boardmemo.

Trends in Delaware litigation


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The past year has led to two cutting-edge developments in Delaware law that boards should factor into their deliberations going forward: first, a streamlined test for demand futility that will impact all derivative cases against Delaware companies, and second, decisions concerning material adverse effect (MAE) clauses and ordinary course covenants in light of the COVID-19 pandemic that reaffirmed the Delaware Courts' reluctance to permit parties to terminate deals based on unfavorable post-signing events.

Delaware Supreme Court establishes a streamlined demand futility test in derivative cases

For years, the Delaware Courts used two different tests to analyze demand futility. The first, set forth in *Aronson v. Lewis*,[1] excused pre-suit demand if there was a reasonable doubt that the directors were disinterested and independent *or* that the challenged action was the product of a valid business judgment. The second, set forth in *Rales v. Blasband*,[2] was limited to *Aronson*'s first prong and only required a showing that the board could not have properly exercised its independent and disinterested business judgment in responding to a demand. The differences between the *Aronson* and *Rales* tests are significant, and in some cases potentially outcome-determinative, although when to apply each test was often unclear.

In *United Food and Commercial Workers Union v. Zuckerberg*,[3] the Delaware Supreme Court jettisoned the *Aronson* and *Rales* dichotomy and instead imposed a universal, three-part test for assessing demand futility. Under this new test, judges should ask three questions on a director-by-director basis to determine whether demand should be excused as futile:

1. whether the director received a material personal benefit from the alleged misconduct that is the subject of the litigation demand;

2. whether the director faces a substantial likelihood of liability on any of the claims that would be the subject of the litigation demand; and

3. whether the director lacks independence from someone who received a material personal benefit from the alleged misconduct that would be the subject of the litigation demand or who would face a substantial likelihood of liability on any of the claims that are the subject of the litigation demand.

[1] *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984).
[2] *Rales v. Blasband*, 634 A.2d 927 (Del. 1993).
[3] *United Food and Commercial Workers Union v. Zuckerberg, et al.*, — A.3d —, 2021 WL 4344361 (Del. Sup. Ct. Sept. 23, 2021).

If the answer to any of these questions is "yes" for a majority of the board members who would evaluate the demand (or at least half for an even-numbered board), then demand is excused as futile and the stockholder may proceed to litigate on the company's behalf. The refined test, the Court explained, "refocuses the inquiry on the decision regarding the litigation demand, rather than the decision being challenged."

The *Zuckerberg* decision is a welcome development, bringing much-needed clarity to a complex area of law and minimizing litigation over whether *Aronson* or *Rales* should apply. It also reinforces the high pleading burden stockholder plaintiffs must meet where the company has adopted an exculpatory provision protecting directors from liability for breaches of the duty of care. In those circumstances, absent allegations of breaches of the duty of loyalty, there can be no "substantial likelihood of liability" sufficient to excuse demand, even where, for example, a challenged transaction is subject to entire fairness review. Because the test for futility emphasizes nonexculpated risk of liability, key action items for boards following *Zuckerberg* include:

- conducting an assessment of strategic risk areas;
- updating that assessment with new areas of risk over time;
- ensuring that management is elevating more detail to the board, especially for "mission-critical" risks;
- creating specialized board committees devoted to key risk areas;
- reacting quickly to corporate trauma; and
- monitoring for potential conflicts that could defeat director independence.

COVID-19 MAE litigation

The Delaware Courts have been historically reluctant to allow buyers to invoke MAE clauses to escape from M&A deals, granting relief to a buyer under an MAE clause in only one pre-pandemic case. With the worldwide spread of COVID-19, multiple buyers invoked the pandemic as a reason to terminate deals and turned to the Delaware Courts for relief. Analyzed together, the recently decided cases on this issue make clear that the heavy burden on buyers imposed by Delaware law remains unchanged and that the pandemic, while a unique event with profound economic effects, provides an insufficient basis standing alone to terminate.

In *AB Stable VIII LLC v. Maps Hotels and Resorts One LLC*,[4] for example,

> "Analyzed together, the recently decided Delaware cases make clear that the pandemic provides an insufficient basis to terminate deals.

the Court held that the pandemic fell within the "natural disasters and calamities" exception to the definition of an MAE under the parties' agreement, emphasizing that the provision was "seller-friendly" given its omission of a common exclusion to the exception for events that have a "disproportionate effect" on the target. The Court, however, did hold that the target's responses to the pandemic, including closing two of its hotels and substantially reducing operations and staffing at others, breached the agreement's ordinary course covenant, thus permitting the buyer to terminate the deal.

In *Snow Phipps Group, LLC v. KCAKE Acquisition, Inc.*,[5] the Chancery Court held that a decline in sales of the target cake decoration supplier due to the pandemic was insufficient under the parties' MAE clause to allow the buyer to terminate the $550m purchase agreement because the sales decline was unlikely to be durationally significant and indeed was already rebounding. In addition, the decline fell within the MAE clause's exception for effects arising from changes in laws, and thus was not materially disproportionate to the target's peers. Similarly, the Court held that the ordinary course covenant was not violated because, among other reasons, the target's $15m draw on a $25m revolver was not inconsistent with its past practice, was the result of a policy applied by the target's private equity parent to all portfolio companies, and was ultimately never spent.

Similarly, in *Bardy Diagnostics, Inc. v. Hill-Rom, Inc.*,[6] which involved post-signing regulatory developments, the Court required the buyer to close on its merger with medical device startup Bardy, even after regulators reduced the reimbursement rate for Bardy's flagship heart monitor by more than 50 percent a few weeks after signing. According to the Court, the buyer did not prove durational significance, given that the rate was likely to be revisited due to its considerable impact on a socially valuable product category, and in any event, the buyer had forecasted that the target, as a startup, would not be immediately profitable. The Court also held that the rate reduction was a "change in healthcare law," which fell within the MAE carve-out and that the catch-all "disproportionate impact" clause did not apply because the impact on the target's revenue and profitability differed from its principal competitor by only a few percentage points.

[4] *AB Stable VIII LLC v. Maps Hotels and Resorts One LLC*, 2020 WL 7024929 (Del. Ch. Nov. 30, 2020).
[5] *Snow Phipps Group, LLC v. KCAKE Acquisition, Inc.*, 2021 WL 1714202 (Del. Ch. Apr. 30, 2021).
[6] *Bardy Diagnostics, Inc. v. Hill-Rom, Inc.*, 2021 WL 2886188 (Del. Ch. July 9, 2021).

Key takeaways for boards

In light of these decisions, key action items for boards include:

1. Ensuring an agreement's MAE clause, including any carve-outs and "disproportionate impact" provision, is adequately clarified.
2. Remaining mindful of the types of actions that might breach an ordinary course covenant.
3. Ensuring that agreements contain a sufficiently specific remedies provision.
4. Remaining mindful of the reluctance of Delaware Courts to permit termination on the basis of an MAE.

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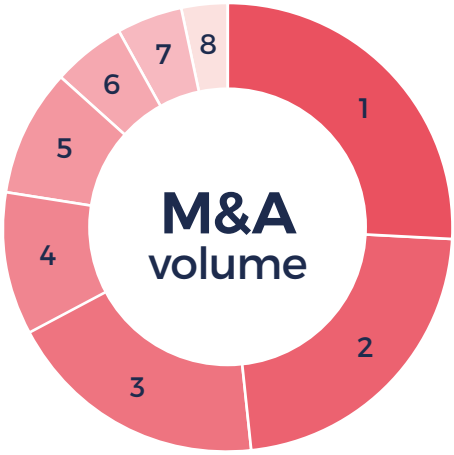
Global M&A YTD, activity by sector

Sector	Value $bn	%
1 TMT	1,521.6	27.47
2 Industrials and materials	824.4	14.89
3 Financials	771.8	13.94
4 Consumer*	746.2	13.47
5 Healthcare	485.6	8.77
6 Energy and power	462.9	8.36
7 Real estate	454.8	8.21
8 Infrastructure and transport	270.8	4.89
Total	**5,538.1**	**100**

* Includes retail



Sector	Volume	%
1 TMT	14,297	26.06
2 Consumer*	12,258	22.35
3 Industrials and materials	10,329	18.83
4 Financials	5,636	10.27
5 Healthcare	5,077	9.26
7 Real estate	2,904	5.29
6 Energy and power	2,551	4.65
8 Infrastructure and transport	1,803	3.29
Total	**54,855**	**100**

* Includes retail

Source: Refinitiv | Data correct to 12/09/2021

Global M&A YTD – value and volume

Global*

M&A value
$5,538bn

M&A deal volume
54,856

Top 3 deals

1	Warner Media/ Discovery	$65.3bn
2	Telecom Italia/ KKR & Co	$40bn
3	MSP Recovery/ Lionheart Acquisition Corp II	$32.5bn

Inbound: most targeted markets

US 13,910 deals	$2,568bn
UK 4,071 deals	$403bn
China 7,093 deals	$394bn

Outbound: most acquisitive markets

US 14,711 deals	$2,772bn
China 6,811 deals	$381bn
Australia 1,475 deals	$271bn

USA*†

M&A value
$2,568bn

M&A deal volume
13,910

Top 3 deals

1	Warner Media/ Discovery	$65.3bn
2	MSP Recovery/ Lionheart Acquisition Corp II	$32.5bn
3	GE Capital Aviation Services/AerCap Holdings	$31.2bn

Inbound: markets investing into US companies

US 11,008 deals	$2,086bn
Canada 615 deals	$92bn
Ireland 48 deals	$59bn

Outbound: markets US companies are investing into

US 11,008	$2,086bn
UK 689 deals	$132bn
Australia 195 deals	$51bn

Europe*†

M&A value
$1,276bn

M&A deal volume
16,216

Top 3 deals

1	Telecom Italia/ KKR & Co	$40bn
2	Western Power Distribution/National Grid One Holdings	$20.1bn
3	Polestar Performance/ Gores Guggenheim	$19.8bn

Inbound: markets investing into European companies

US 1,887 deals	$369bn
UK 2,942 deals	$142bn
France 1,786 deals	$135bn

Outbound: markets European companies are investing into

US 956 deals	$238bn
UK 2,704 deals	$140bn
France 1,648 deals	$130bn

Asia-Pacific*†

M&A value
$1,183bn

M&A deal volume
18,489

Top 3 deals

1	Grab Holdings/ Altimeter Growth	$31.1bn
2	Afterpay/Square	$27.7bn
3	Sydney Airport Holdings Pty/ Investor Group	$23.2bn

Inbound: markets investing into Asia-Pacific companies

China 6,585 deals	$358bn
US 816 deals	$169bn
Australia 1,253 deals	$152bn

Outbound: markets Asia-Pacific companies are investing into

China 6,817 deals	$377bn
Australia 1,296 deals	$147bn
Japan 3,600 deals	$124bn

Financial sponsor M&A – top 3 deals with buyside financial sponsor involvement

1. **$40bn** – Telecom Italia/KKR & Co
2. **$27.7bn** – Afterpay/Square
3. **$23.2bn** – Sydney Airport Holdings Pty/ Investor Group

* Deal value includes net debt of target | † Includes domestic deals | Source: Refinitiv | Data correct to 12/09/2021