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Mergers & Acquisitions

2020

Ninth Edition

Editors:
Lorenzo Corte & Scott C. Hopkins

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GLOBAL LEGAL INSIGHTS – MERGERS & ACQUISITIONS

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CONTENTS

FROM THE PUBLISHER

Dear Reader,

Welcome to the ninth edition of *Global Legal Insights – Mergers & Acquisitions*, published by Global Legal Group.

This publication provides corporate counsel and international practitioners with comprehensive jurisdiction-by-jurisdiction guidance to mergers and acquisitions regulations around the world, and is also available at www.globallegalinsights.com.

The chapters, which in this edition cover 20 jurisdictions, provide detailed information for professionals dealing with mergers and acquisitions.

As always, this publication has been written by M&A lawyers and industry specialists, for whose invaluable contributions the editors and publishers are extremely grateful.

Global Legal Group would also like to extend special thanks to contributing editors Lorenzo Corte and Scott C. Hopkins of Skadden, Arps, Slate, Meagher & Flom (UK) LLP for their leadership, support and expertise in bringing this project to fruition.

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Overview

2019 M&A numbers

Following the uptick in overall global M&A volume in 2018 over the previous year, the approximately 36,000 transactions that closed globally in 2019 represented an 8% drop in number of transactions from the previous year, while the $3.1 trillion worth of transactions that closed in 2019 represented a 14% drop from 2018 in deal value.

In contrast, the domestic M&A market continued to be robust, with the overall value of transactions based in North America exceeding $2 trillion as it has for the last few years. In keeping with the trend in recent years, this volume level was again aided by a large number of "mega-deals", including two deals valued in excess of $70 billion each: Bristol Myers Squibb's acquisition of Celgene Corporation; and the acquisition of Raytheon Company by United Technologies Corporation. Indeed, of the 11 largest global transactions announced in 2019, nine involved both a U.S. target and U.S. acquiror and those nine deals accounted for approximately 23% of the overall value of domestic M&A activity. Transactions in excess of $500 million constituted roughly 75% of the aggregate deal value of M&A activity while accounting for slightly more than 10% of the number of total transactions. This activity was significantly driven by large-scale deals in the healthcare and information technology ("IT") sectors. The median transaction size in North America was $76.4 million, a $16.4 million increase from 2018.

Overall, inbound investment in the United States witnessed a 16% decline in total deal value and a 1.2% decrease in the total number of deals in 2019 compared to 2018. Macroeconomic deceleration and political tension both have a role to play. In particular, isolationist rhetoric and trade disputes have continued to dissuade potential Chinese buyers from purchasing U.S.-based assets, as well as heightened scrutiny of foreign investments in the United States by the Committee of Foreign Investment in the United States ("CFIUS"). 2019 marked the third straight year of decreases in cross-border transactions with China. Chinese acquisitions of North American targets experienced significant declines from 2018 to 2019 of 60.4% and 81.6% in number and value, respectively.

Similarly, inbound investment levels from Canada and Europe have declined. Uncertainty surrounding the negotiation of the United States–Mexico–Canada Agreement ("USMCA"), set to go into effect in July 2020, likely impacted the flow of Canadian investment, while the uncertainty over the terms of Brexit in the United Kingdom and much of the European Union has had a negative ripple effect on Europe's appetite for overseas investing. The sustained strength of the dollar and U.S. equity markets that were high for much of the year have also served to make inbound U.S. acquisitions more expensive. Canada remained the leading nation for inbound M&A activity in 2019, followed by the United Kingdom and France as measured by aggregate dollar value and by Japan and the United Kingdom as measured by the number of transactions.

Although the end of 2019 saw continued anxiety regarding an anticipated economic recession, the arrival of COVID-19 in the first quarter of 2020 has disrupted all projections. M&A activity in North America in the first quarter of 2020 reached $400.8 billion dollars, representing a 25.1% decline from the first quarter of 2019, while the number of closed transactions increased slightly to 3,169, representing a slight 2.6% gain over the same period. It is likely that a very significant number of the transactions entered into or closed in the first quarter were prior to the global awareness of the severity of the public health threat presented by COVID-19. The decline in the number of multi-billion-dollar deals directly resulted in a dramatic drop in deal value; the total value of M&A deals in excess of $1 billion was $132.8 billion in the first quarter of 2020, marking the lowest figure since the first quarter of 2014. In addition to an immediate focus on stabilising companies, amending existing debt facilities for a difficult period ahead, assessing the eligibility of companies for governmental stimulus packages such as the U.S. Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"), undertaking cost-cutting measures and navigating workforce issues arising from shutdowns and quarantines, the diminished appetite of financial sponsors for larger deals played a role in declining M&A mega-deals; such deals are typically too large for a single private equity firm and club deals are logistically more complex to arrange. Despite a few bright spots, M&A multiples appear to be deflating, with the rolling four-quarter median falling from 10.1× in the last quarter of 2019 to 9.8× in the first quarter of 2020. COVID-19, coupled with lower CEO confidence and potential future tightening of the credit markets (although given the significant recent growth of credit funds and other structured alternatives, this risk may be less likely now than in the last downturn), are expected to accelerate this decline.

U.S. dealmaking

Strategic *v.* PE dealmaking

Sponsor-backed M&A activity levels in the United States in 2019 increased slightly over 2018 in terms of the number of deals but decreased significantly as a proportion of overall M&A activity. In 2019, 9% of all transactions in the United States were closed by financial buyers, and the remaining 91% were closed by strategic buyers, according to S&P Capital IQ data. As a comparison, in 2018, 29% of all transactions were closed by financial buyers, while strategic buyers accounted for the remaining 71%.

The competition and pressure to deploy capital among private equity firms remained strong in 2019 as private equity firms found themselves with a $1.5 trillion war chest of accumulated capital. Fundraising rose to an all-time high in 2019, though the median holding time for funds dropped from a high of 5.9 years in 2014 to 4.9 years in 2019. Blackstone Capital Partners, Vista Equity Partners, TPG Capital, Leonard Green and Veritas raised the largest funds, each of them exceeding $10 billion. Commitments for Blackstone Capital Partners VIII reached $26 billion, the largest private equity vehicle of all time.

Shareholder activism

Despite a decline in public activist campaigns, shareholder activism continued to play a significant role in 2019, with a number of new entrants in the space. Although the number of companies publicly targeted and the average capital deployed declined from 2018 levels, the number of investors launching campaigns represents an all-time high at 147 investors. M&A-related activism included multiple instances of activists pushing or opposing announced transactions or seeking spinoffs or break-ups. A number of household names were targeted in 2019, including AT&T (which was the largest company targeted, with a market capitalisation at the time in excess of $250 billion), HP, Caesars, eBay and Bristol Myers Squibb.

Investors continued to utilise proxy contests, or the threat of proxy contests, to obtain board seats. Of the 122 board seats that were won in 2019, only 20 were obtained through an actual shareholder vote, indicating that most companies prefer to concede a board seat to an investor rather than engage in a costly and protracted battle that takes place in the public spotlight. A settlement also spares a company from potentially losing a proxy contest, which could indicate a loss of confidence by shareholders in its management and/or the Board.

Focus on social issues

Investors continued to place an emphasis on environmental, social and governance ("ESG")-related and corporate social responsibility issues in 2019. A majority of shareholder proposals included in proxy statements in 2019 were ESG-related. Proposals related to disclosure on political contributions/lobbying and climate change were the two leading ESG issues. Additionally, the U.S. Business Roundtable, a group of executives of over 150 major U.S. companies and institutional investors, issued its "Statement on the Purpose of a Corporation" in August 2019, which referenced taking into account a wider range of stakeholders than serving the best interests of only shareholders, a re-evaluation which was endorsed by Leo E. Strine, Jr., former Chief Justice of the Delaware Supreme Court. The Statement called on companies to also consider the needs of employees, customers, suppliers and communities, and echoes other mechanisms such as constituency statutes and incorporation as a B-corporation to broaden the purpose of capitalism. While the focus on ESG issues is not as far along as in Europe and is advancing among U.S. public companies, the U.S. private equity industry is becoming sensitised to the importance of such issues from a diligence and investment perspective, partly due to pressure from limited partners such as CalPERS, the California state retirement pension authority. It is as yet unknown whether COVID-19 will contribute to a meaningful retrenchment from this exploration of the purposes of the corporation, or whether it will help accelerate this trend towards stakeholder capitalism as the devastating economic and social impact of the pandemic ripples through our society.

Industry sector focus

In 2019, Industrials, IT and Consumer Discretionary were the three sectors with the most M&A activity in the United States, as determined by number of transactions according to S&P Capital IQ data. Approximately 23% of the U.S. transactions closed in 2019 were in the Industrials sector, 16% were in the IT sector and 16% were in the Consumer Discretionary sector. These numbers are slightly different than the industry breakdown of M&A activity that was seen in 2018, where approximately 21% of the U.S. transactions were in the IT sector, 19% were in the Industrials sector and 13% were in the Consumer Discretionary sector. In 2019, IT comprised 19.9% of total M&A value in North America, the second-highest percentage on record for the sector, according to PitchBook data. After three consecutive years of declines, healthcare M&A value increased in 2019, commanding a respectable 15.6% of all North American M&A value. The COVID-19 pandemic is expected to increase the percentage of transactions in healthcare and IT. For example, the IT sector's share of total deal value for North America in the first quarter of 2020 compared to the first quarter of 2019 increased from 17.4% to 21.7%.

Key developments

<u>Case law developments</u>

There have been certain significant decisions in 2019 originating out of the Delaware and New York courts that are of particular interest to the M&A legal community. The cases discussed below address: the standards of review for transactions, continuing the refinement of the *MFW* and *Corwin* doctrines; the importance of Board oversight during crises, confirming the potential risk of *Caremark* liability; mechanisms to protect privileged communications; the scope of books and records demands to cover informal electronic communications; and the importance of nuanced contract drafting. There may be developments relating to these cases arising subsequent to the original publication date of this chapter on July 2, 2020.

Standards of review for transactions: Continued refinement of MFW and Corwin doctrine in Olenik and Towers Watson

In the *Olenik v. Lodzinski* case, the Delaware Supreme Court provided further guidance regarding the circumstances under which reliance on certain procedural protections pursuant to the so-called "*MFW* standard" can operate to restore the presumption of the business judgment rule to a controlling stockholder buyout. In the 2014 case *Kahn v. M&F Worldwide Corp.* ("*MFW*"), the Delaware Supreme Court held that the director-friendly protections of the business judgment rule would apply to a going private transaction proposed by a controlling stockholder when the controlling stockholder conditioned the transaction *ab initio* on two procedural protections: (1) the approval by an independent, fully empowered special committee that fulfils its duty of care; and (2) the uncoerced, informed vote of a majority of the minority stockholders. In *Olenik*, the parties had what the Delaware Court of Chancery characterised as "preliminary" and "exploratory" discussions for 10 months before the buyer imposed the *MFW* protections in its formal offer and the special committee was formed. The Delaware Supreme Court found, however, that those early discussions had included "substantive economic negotiations" because the parties had "set the playing field" for the high and low ends of the deal pricing. The Delaware Supreme Court therefore held that *MFW* protections did not apply, and emphasised that the *MFW* standard must be imposed early in the process and indicated that the appropriate time is "during the germination stage of the Special Committee process", which is when advisors are being selected, due diligence is beginning, and before there has been "any economic horse trading". The *Olenik* decision provides guidance around the specific point in time by which the procedural safeguards established in *MFW* need to be in place and also indicates that Delaware courts are prepared to engage in factual investigations into whether the requirements of *MFW* have been strictly met.

The *In Re Towers Watson & Co. Stockholders Litigation* case continued the trend of Delaware courts to presume application of the business judgment rule. Much like certain decisions covered in the Eighth Edition of *Global Legal Insights – Mergers & Acquisitions*, this case turned on whether the plaintiff-stockholders had sufficiently plead facts to rebut the presumption of the business judgment rule in connection with the proposed "merger of equals" of Towers Watson and Willis Group Holdings plc. The plaintiff-stockholders asserted that Towers Watson's Chief Executive Officer ("CEO") had breached his fiduciary duties by failing to properly disclose to the Board of Directors that, while negotiating the merger, the CEO had received a compensation proposal from Willis' second-largest stockholder. The Court found that the compensation proposal was ultimately immaterial, reasoning that the independent Board members were well aware that the merger would presumably lead to an increase in compensation for the CEO. Because the transaction was primarily a stock-for-stock merger, the Court explained that there was no dispute that the business judgment rule presumptively applies, concluded that plaintiff-stockholders had failed to rebut that presumption and declined to invoke the "recently fashionable *Corwin* doctrine" which would assess the adequacy of deal protections such as a fully informed, uncoerced stockholder vote. However, in a related case, *In re Willis Towers Proxy Litigation*, brought in federal court, the United States Court of Appeals for the Fourth Circuit held that the failure to disclose such compensation discussions in the proxy materials mailed to stockholders constituted sufficient grounds to support claims that the proxy materials omitted material facts in violation of the U.S. Securities Exchange Act.

Board oversight: Confirming potential Caremark liability in Marchand and In re Clovis

Two decisions by Delaware courts in 2019 revived discussions surrounding the nature and scope of a Board of Directors' duty of oversight, historically viewed as among the most difficult theories in corporate law upon which plaintiffs could prevail. Such breach of duty of oversight claims, known as "*Caremark* claims" based on the seminal 1996 *In re Caremark* decision, require a plaintiff to demonstrate that the Board "utterly failed" to adopt controls and systems for reporting "mission critical" legal and business risks to the Board or, if a system has been established, that the Board failed to continually and effectively monitor it. In *Marchand v. Barnhill*, the Delaware Supreme Court reversed the dismissal of plaintiff-stockholders' *Caremark* claims against the directors of Blue Bell Creameries USA, Inc. following an outbreak of listeria in its facilities that resulted in three deaths. Blue Bell Creameries suffered significant financial harm, as well as a number of costly lawsuits following the outbreak. The Delaware Supreme Court found that the Board of Directors had failed to establish any food safety reporting systems or controls, which the Court viewed as a "mission critical" risk for that business, thereby laying the groundwork for the viability of *Caremark* claims against the Board. The actions of the former CEO of Blue Bell Creameries were so egregious that he was eventually indicted in May 2020 on criminal charges alleging efforts to deceive customers about contaminated products.

Following the *Marchand* decision, the Delaware Chancery Court in *In re Clovis Oncology Inc. Derivative Litigation* declined to dismiss plaintiff-stockholders' *Caremark* claims. In this case, the plaintiffs did not allege that the Board of Clovis Oncology Inc. failed to have the proper systems in place for oversight and reporting, as the Nominating and Corporate Governance Committee of the Board was designated to provide compliance oversight. Rather, the plaintiffs alleged that the Board had failed to sufficiently monitor the oversight system, by failing to act upon "red flags" raised during the company's late-stage clinical trial for its developmental oncology drug. While *Marchand* and *In re Clovis* indicate a willingness by the Courts to allow *Caremark* disputes to survive motions to dismiss, particularly for Boards overseeing companies in highly regulated industries where the application and effectiveness of corporate compliance and related reporting systems and controls are "mission critical" corporate risks, these cases do not necessarily represent a change in the law regarding *Caremark* claims or stand for the proposition that plaintiffs will ultimately prevail in such cases. However, effective Boards should identify mission critical risks and take steps to implement and continually review and monitor "reasonable compliance and reporting systems" in order to properly exercise their duties of oversight.

Protection of privileged communications: Reminders of best practices in Shareholder Rep Services and Argos

Delaware and New York courts provided reminders of the importance of preserving attorney-client privilege in transactions through contracts as well as by following best practices. In *Shareholder Representative Services LLC v. RSI Holdco, LLC*, the Delaware Court of Chancery revisited the issue of when a buyer in a merger transaction may use the target's privileged pre-merger communications in post-closing litigation against the sellers. The buyer in *RSI Holdco* obtained possession of the target company's computers and email servers that contained approximately 1,200 pre-merger emails between sellers and their counsel, which the buyer sought to use in post-closing litigation, arguing that the sellers had not taken steps to segregate privileged communications and had effectively waived privilege. The Court previously addressed this in *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP*, where it found that the sellers waived their ability to assert privilege in a merger because they neither negotiated for that right in the merger agreement, nor prevented the surviving company from taking actual possession of the communications. The Court in *RSI Holdco*, however, concluded there was no similar waiver of privilege, finding that the sellers had used their contractual freedom to negotiate a carve-out provision in the merger agreement that affirmatively preserved their right to assert privilege over pre-merger attorney-client communications and specifically prevented the buyer from using such communications in post-closing litigation. The case cautions that sellers should negotiate for the preservation and control over pre-closing privileged communications in their sale and merger agreements, which will be respected, despite the absence of efforts to segregate and excise such communications by closing.

A federal court in the Southern District of New York provided guidance in *Argos Holdings Inc. and PetSmart Inc. v. Wilmington Trust N.A*. with regard to preserving privilege in the context of communications between counsel to a portfolio company's Board and directors who were also partners in the private equity sponsor of such portfolio company. Plaintiff Argos was the sole stockholder of plaintiff PetSmart, and the sponsor-designated directors of the portfolio company were principals of the private equity sponsor of Argos. In connection with the acquisition by PetSmart of Chewy, Inc. and subsequent transfers of Chewy's stock, plaintiffs filed suit against Wilmington as the administrative agent, during the course of which plaintiffs asserted their privilege with regard to certain communications between their law firms and the sponsor-designated directors. Plaintiffs contended that "where there is no conflict of interest, a stockholder is entitled to assert the privilege as to communications with its representatives on the Board of Directors of one of its portfolio companies", while the defendant argued that unless the entities are jointly represented or the common interest doctrine applies, an investor may not invoke the privilege possessed by the portfolio company. The Court agreed with the defendant on this point and found that the sponsor-designated directors had received the relevant communications in their capacity as partners of the private equity sponsor, rather than as Board members of the portfolio company. Among other things, those communications were sent only to the sponsor-designated directors, not the full Board of the portfolio company, and were sent to their sponsor email addresses, rather than PetSmart addresses. Aside from the portfolio company and private equity sponsor entering into a common interest agreement to extend the privilege from the portfolio company to its private equity sponsor, plaintiffs should have established documents, protocols and training designed to protect the privilege, including measures to prevent disclosure (and therefore, inadvertent waiver of privilege) to private equity sponsors of privileged communications between counsel to a portfolio company's Board and sponsor-designated directors, and maintained the distinction between using portfolio company email addresses and private equity sponsor email addresses/servers.

Scope of demand rights: Focus on broad rights in Schnatter and KT4 Partners

There was renewed focus on the scope of access to books and records under Section 220 of the Delaware General Corporation Law (as amended, "DGCL") and recognition of the evolving use of technology in corporate communications, as demonstrated by *Schnatter* *v. Papa John's International* and *KT4 Partners LLC v. Palantir Technologies Inc*. The former case involved a demand by Mr. Schnatter as a director of the pizza company to inspect certain categories of documents in response to the Company's decisions to terminate certain agreements it had with Mr. Schnatter following publication of a negative *Forbes* magazine article on him. Mr. Schnatter is also the Company's founder, largest stockholder and former chairman of the Board. Mr. Schnatter stated that the demand inspection request was to ensure that the Board was fulfilling its fiduciary duties in connection with how he was treated. The Delaware Court of Chancery determined that the Company failed to show that Mr. Schnatter's demand request was improper merely because it was personal and failed to show that it was not reasonably related to his position as a director because Mr. Schnatter's image was inextricably linked with the Company's brand. In its decision, the Court reaffirmed the distinction between demands made by stockholders (who must show proper purpose related to interests as a stockholder and any requested documents must be necessary to such purpose) and those by directors (who have much broader rights of access under demand rights). The opinion also confirms that demand rights may extend to emails and text messages from personal accounts and those stored on personal devices in recognition of the expanded formats in which relevant communications may exist.

In another case, *KT4 Partners LLC v. Palantir Technologies Inc.*, the Delaware Supreme Court considered the question of access under a stockholder demand request to investigate suspected wrongdoing by seeking electronic communications of directors and senior management (i.e., emails and other informal communications). The Company had recently amended its investor rights agreement to eliminate contractual inspection rights held by Palantir and other stockholders, who subsequently filed a demand request under DGCL Section 220. Here, the Delaware Supreme Court reversed the lower court's decision which had upheld a traditional view that stockholders may access only formal Board-level documents. In its decision, the Court noted that the Company lacked formal minutes and Board materials, preferring to conduct business through emails. Companies should proceed with caution in opposing a director's demand rights under DGCL Section 220, given the broad rights they generally enjoy, and should adhere to corporate formalities of documenting their processes in minutes and other formal presentations so as to minimise the ability of stockholders to request electronic communications.

Contract interpretation

Oxbow: Courts are reluctant to write a provision into a contract when the parties could have done so themselves

In *Oxbow Carbon & Minerals Holdings, Inc. v. Crestview-Oxbow Acquisition, LLC*, the Supreme Court of Delaware reviewed the Court of Chancery's interpretation of an exit sale provision in an LLC Agreement. The Court of Chancery had held that a gap exists in the LLC Agreement relating to the terms on which the two minority members affiliated with the majority had become members due to the silence of the Company's Board as to the terms of admission and rights of these minority members and the failure of the Company to follow corporate formalities, such as obtaining pre-emptive rights waivers in connection with the issuances to these minority members. Relying on the implied covenant of good faith and fair dealing to ask what the parties would have agreed to themselves had they considered the issue in their original bargaining positions at the time of contracting, the Court "filled the gap" by allowing certain non-affiliated minority members to force a multi-billion-dollar sale as a solution to the perceived gap.

In a unanimous decision, the Supreme Court affirmed the lower court's plain language interpretation which gave effect to multiple provisions in the LLC Agreement when read together, but it reversed the lower court opinion to the extent that it had inserted the implied covenant of good faith and fair dealing as a gap filler to the contractual provisions. Under the Supreme Court's interpretation of the plain language of the LLC Agreement, these affiliated minority members are entitled to block an exit sale. The Supreme Court noted that the permissive discretion given to the Board in the LLC Agreement was a contractual choice, and the lack of exercise of that discretion did not equate to a contractual gap. The Court emphasised that, even where a contract is truly silent concerning the matter at hand, under precedent a court "should be most chary about implying a contractual protection when the contract could easily have been drafted to expressly provide for it". Sophisticated transaction parties should be very precise in drafting exit provisions, comply with the requirements of admission and consider how existing rights and percentages should be calculated with respect to newly admitted members.

Vintage Rodeo and Genuine Parts: Contracts are to be interpreted in a way that does not render any provisions illusory or meaningless

In *Vintage Rodeo Parent, LLC v. Rent-A-Center, Inc.*, the Delaware Court of Chancery applied a contract's extension, termination, notice and waiver provisions, which it considered to be clear and unambiguous, and accordingly declined to deviate from such terms despite the plaintiffs' argument that the purchaser entity had constructively complied with the notice provision for extension. The merger agreement between the plaintiffs/acquirors and the defendant/target specified an end date ("End Date"), which could be extended at the unilateral election of either party by written notice, and allowed for termination by either party upon written notice after the End Date. Plaintiff Vintage failed to provide notice extending the End Date under the terms of the merger agreement. Very shortly following the End Date, defendant Rent-A-Center gave Vintage notice of termination and demanded payment of an outsized but agreed-upon termination fee (representing 15.75% of deal value) from Vintage. Plaintiffs argued that, during the course of dealing, the parties had represented the closing would not take place until after the End Date. But the Court declined to find the agreement's extension requirement a "meaningless formality". Neither plaintiffs' nor defendant's statements about an expected closing following the End Date was sufficient to satisfy a contractual notice requirement extending the End Date. This case highlights that courts will enforce an agreement's disputed provision as clearly written.

In *Genuine Parts Company v. Essendant Inc.*, the Delaware Court of Chancery considered a termination provision's connection with other sections in a merger agreement in order to interpret the operative terms of the agreement as a whole. Defendant Essendant had received earlier interest from a potential acquiror, Sycamore Partners, whose portfolio includes the office supplies chain Staples. The defendant subsequently entered into an acquisition agreement with plaintiff Genuine Parts, which contained a general non-solicitation provision, with an exception allowing Essendant's Board of Directors to provide information to and have discussions with any person who has made a written offer that did not arise from a breach of the non-solicitation covenant and that the Board determines is, or is likely to lead to, a "Superior Proposal". After executing the Genuine Parts agreement, the defendant Essendant accepted a revised acquisition offer from Sycamore Partners, terminated the Genuine Parts agreement and paid a termination fee, and proceeded to close the deal with Sycamore Partners. Plaintiff Genuine Parts argued that Essendant materially breached the non-solicitation covenant such that recovery should not be limited to the termination fee. Essendant moved to dismiss, arguing that the termination fee was the exclusive remedy under the agreement, which the plaintiff acknowledged in accepting the fee. The Court denied the motion to dismiss, finding the merger agreement's language was not clear and unambiguous in limiting the remedy to exclusively the termination fee. Due to cross-references between the exclusive remedy, termination and non-solicit provisions, the termination fee was Genuine Parts' exclusive remedy for termination if Essendant had paid the fee "in accordance with" the exception to the non-solicitation provision. The Court found the only reasonable construction when considering the various terms at issue allowed the plaintiff to argue that the exclusive remedy provision does not apply because there was no Superior Proposal from Sycamore Partners; and, if there was one, it resulted from a material breach by Essendant of its non-solicitation obligation. Accordingly, the plaintiff's acceptance of the termination fee did not preclude it from pursuing breach of contract claims against the defendant.

Channel: Courts will interpret materiality standards under precedent

At issue in *Channel Medsystems, Inc. v. Boston Scientific Corporation* were plaintiff's purported breaches of representations arising from fraud by an employee, including in submissions to the U.S. Food and Drug Administration in connection with the medical device product of the target, Channel Medsystems, and whether they entitled the buyer, Boston Scientific, to terminate the merger agreement with Channel Medsystems – this was the first post-*Akorn* Delaware case to revisit the determination of a material adverse effect ("MAE"). The merger agreement included a customary closing condition that representations would be brought down at closing, subject to an MAE standard. Because the representations at issue contained materiality qualifiers, the Delaware Court of Chancery first considered whether the inaccuracies in the plaintiff's representations were material. Materiality was not defined in the merger agreement, so the Court applied the *Frontier Oil* test – whether there is "substantial likelihood that the ... fact [of breach] would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information". The Court found the inaccuracies were material. The Delaware Court of Chancery next considered whether, under the terms of the agreement, the failure of such representations to be true and correct at closing breached the MAE standard. For purposes of assessing materiality in the context of an MAE, the Court relied on the 2018 *Akorn, Inc. v. Fresenius Kabi AG* case to determine whether the effect "substantially threaten[s] the overall earnings potential of the target in a durationally-significant manner", where an 86% decline in the target's EBITDA, which was likely to continue, was determined to meet this standard. The Court also noted that Boston Scientific was unwilling to confer with the target or seek additional information over its concerns, as required by Boston Scientific's obligations to use reasonable efforts to close the transaction. Under the high bar set by the *Akorn* decision, the Court held that the Boston Scientific defendants were not entitled to terminate the merger agreement and granted specific performance to close the transaction.

<u>FIRRMA and antitrust developments</u>

Final rules to implement FIRRMA effective February 2020

On September 17, 2019, proposed regulations to implement the U.S. Foreign Investment Risk Review Modernization Act ("FIRRMA") were issued by the U.S. Department of the Treasury for public comment, and on January 13, 2020, the final rules to implement FIRRMA were released, effective February 13, 2020. In October 2018, the U.S. Department of the Treasury had issued interim regulations and introduced a "pilot program" which was largely implemented in these final rules. FIRRMA expands the authority of the interagency CFIUS to review control acquisitions or non-control investments by foreign persons in certain U.S. businesses from a national security perspective, with particular scrutiny of transactions with China. The COVID-19 pandemic has aggravated pre-existing U.S.–China tensions which are likely to result in even more scrutiny of Chinese investments, including by proxies. The drivers for CFIUS reform are multifold: a recognition that early-stage technologies could become strategic for national security; increasing convergence between economic and military security; greater complexity in transaction structures that could result in gaps for review; and changes in China's investment strategy as part of its "Made in China 2025" plan. FIRRMA, as modified by the new regulations, implements changes to CFIUS in two major areas: (1) increasing CFIUS' jurisdictional reach over a broader set of "covered transactions" involving critical technologies in certain sectors; and (2) amending the existing CFIUS review process to require mandatory filings for investments, whether controlling or non-controlling, in U.S. businesses involved in critical **t**echnologies, critical **i**nfrastructure or the maintenance or collection, directly or indirectly, of sensitive personal **d**ata of U.S. citizens (so-called "TID US Businesses"). The final rules clarify certain aspects of FIRRMA such as: the scope of sensitive data; exceptions from mandatory filings for "excepted investors" and other bases (i.e., investments under a valid security clearance and oversight agreements to address foreign ownership, control or influence ("FOCI")); and thresholds for mandatory filings by indirect foreign government investments. The final rules also flag additional areas for future rulemaking, such as the basis for classification of critical technologies and the definition of "emerging and foundational technologies". Practically speaking, these changes lay the framework for a more far-reaching, dynamic and powerful CFIUS that is in the process of transforming how acquisition and investment transactions are being sourced, structured, financed and executed. Even before the impact of the COVID-19 pandemic, many foreign jurisdictions were evaluating the adequacy of their foreign direct investment regimes in the face of new technologies that could become core strategic assets, on the one hand, and the convergence of economic and geopolitical competition with China, Russia and certain other countries, on the other hand. Accordingly, a number of countries such as Australia, France, Germany and Spain have recently passed legislation to expand the scope of their review along similar lines as the United States.

FIRRMA has expanded CFIUS so that it no longer covers only foreign acquisitions of controlling interests in relevant companies. Going forward, CFIUS may review any non-passive, non-controlling foreign investment in a U.S. business that produces, designs, tests, manufactures or develops "critical technology" in 27 specified sensitive industries identified according to North American Industry Classification System ("NAICS") codes, such as electronics, semiconductor manufacturing and nanotechnology/biotechnology research and development. The U.S. Department of the Treasury has signalled that it will move away from classification based on self-reported NAICS codes towards one based on required export control licences in future regulations. Critical technologies include: defence articles or defence services on the U.S. Munitions List set forth in the International Traffic in Arms Regulations ("ITAR"); items on the Commerce Control List set forth in the Export Administration Regulations ("EAR") (when controlled for specific reasons); certain specially designed and prepared nuclear equipment, parts and components, materials, software, and technology; select agents and toxins; and "emerging and foundational technologies". Further, under the final rules' "substantial interest" definition, an investment by a foreign person that constitutes at least a 25% voting interest in a TID US Business and where the foreign person itself is at least 49% controlled, directly or indirectly, by a single foreign government, will trigger a mandatory filing with CFIUS; however, in the case of a private equity fund, such minimum 49% interest needed to qualify as a "substantial interest" must be in the general partner, not the limited partnership. Further, real estate control and non-controlling transactions (whether structured as a sale, lease or concession, whether involving developed or undeveloped land) involving airports or maritime ports or real estate in close proximity to a U.S. military installation or other sensitive U.S. government properties, are subject to CFIUS review. The U.S. Department of Commerce released on March 25, 2020 a webbased reference tool to assist potential investors in determining the applicable geographical proximity or extended range for specific addresses that would trigger CFIUS jurisdiction.

Scope of FIRRMA

For purposes of determining a "foreign person" under CFIUS, the final rules clarify that private equity funds with foreign limited partners will not on that basis alone be "foreign persons", and therefore will fall outside the scope of CFIUS. To do so, they must meet certain criteria including management exclusively by a U.S. general partner who is controlled by U.S. persons, the absence of approval or block rights by investors over general partner decisions and the lack of access by investors to material non-public technical information. Moreover, the "principal place of business" of any fund (i.e., the primary location where the fund's activities are primarily directed, controlled or coordinated on behalf of the general partner) must be within the United States, as stated in its most recent filing (whether tax, regulatory or otherwise) with any federal, state or foreign government, unless shown to be subsequently changed to the United States. Conversely, private equity fund structures that provide foreign limited partners with, among other things, access to material non-public technical information, board or observer rights or any other involvement in substantive decisions (other than through the voting of shares) of certain U.S. portfolio companies will not fall outside CFIUS' jurisdiction because such investments are non-passive and accordingly, a limited partner may have a filing obligation. Funds that may be foreign persons for CFIUS purposes will need to be careful in understanding the export control status of the businesses they propose to invest in, and monitor any subsequent changes in their rights or ownership that could trigger CFIUS' review. The U.S. portfolio companies at issue are those dealing with the use, release or maintaining of sensitive personal data of U.S. citizens, the use, acquisition or release of critical technologies or the management, operation or supply of critical infrastructure. Smaller or emerging companies often do not have the resources or sophistication to assess whether their products and technologies are subject to export control regulations and therefore possibly CFIUS. Further, the U.S. government is continuing to update their export control regime for emerging and foundational technologies, adding further uncertainty to whether a CFIUS filing could be triggered. Accordingly, investors focused on early-stage technology will need to tread carefully, both to avoid incorrect analysis of a mandatory CFIUS filing (for which penalties can be as severe as unwinding the transaction or up to the value of the transaction) as well as allocating identified CFIUS-related deal risk contractually in acquisition/investment documents, whether through closing conditions, stringent interim efforts, covenants addressing potential mitigation measures and use of reverse termination fees payable through enforceable credit support mechanisms.

The definition of "foreign person" under the final regulations exempts investors from the mandatory filing requirement for certain non-controlling, non-passive investments through a "white list" of "excepted foreign states" with particularly close intelligence-sharing relationships with the United States, conditionally limited to Australia, Canada and the United Kingdom. Importantly, these investors continue to remain subject to CFIUS jurisdiction and review for control transactions. "Excepted investors" must be organised under the laws of, and have their "principal place of business" in, the United States or an excepted foreign state, and must have at least 75% of their Board members and each person holding at least 10% of the voting interest of the excepted investor, be nationals from the United States or excepted foreign states and not dual nationals with other states. Another area to monitor is the mandatory filing triggered by non-controlling investments in companies that maintain or collect "sensitive personal data", which, given current data-rich business models, could cover an extensive set of companies today. The final rules indicate that companies that collect, or have the intent to collect, sensitive data on at least 1 million persons over the preceding 12 months would be included as a TID US Business, and that such "sensitive personal data" may include subsets of identifiable genetic, mental or physical health, geolocation, biometric or financial hardship data. CFIUS recognises the potential for foreign actors to exploit, blackmail or monitor individuals through access of personal and medical data.

New CFIUS filing fees effective May 2020

In March 2020, proposed regulations to impose filing fees with CFIUS were released by the U.S. Department of the Treasury, which became effective May 1, 2020. The fee structure is tiered based on transaction value, similar to U.S. antitrust filing fees, and ranges from zero for deals valued at less than $500,000 to a maximum of $300,000 for deals valued at a minimum of $750 million. The fees are payable at the time of submission of formal written notice with CFIUS, whether or not the filing was voluntary or mandatory. Filing the five-page declaration discussed below, whether voluntary or mandatory, does not trigger filing fees. Partly as a result, we may see more short-form declarations filed with CFIUS.

Filings and declarations

A declaration must be filed at least 30 days prior to the closing of a transaction. Upon receiving a declaration, CFIUS will begin a review process, which is statutorily limited to 30 calendar days, as opposed to up to several months for a full standard notice. Timelines may be further extended as a result of office closures, remote working arrangements, and limited access from home to classified information, as necessitated by COVID-19 responses. Upon completion of the review of a declaration, CFIUS may: (i) request that the parties file a full standard notice; (ii) inform the parties that CFIUS is unable to reach a decision and that the parties may file a full standard notice regarding the transaction; (iii) initiate a unilateral review of the transaction; or (iv) clear the transaction. There is no safe harbour other than affirmative clearance. Failure by the parties to file mandatory declarations may result in civil penalties up to the full value of the transaction. CFIUS may negotiate mitigation agreements to address national security risks of particular transactions and, in extreme cases, has authority to unwind a transaction. Mitigation measures historically have included: divestiture of the U.S. business; limiting the transfer of certain intellectual property; providing that only U.S. citizens handle certain products and services and that they are located only in the United States; limiting access to certain technology, information and government contracts to designated persons; and excluding sensitive assets from the transaction. CFIUS has imposed monetary penalties (e.g., a $1 million penalty) for violations of mitigation agreements and interim orders.

The declaration is a five-page filing, instead of the longer 45-page full standard notice. However, while the intent of these short-form declarations may have been to streamline and expedite the review process, it has not yet resulted in quicker review by CFIUS staff already at capacity. In most cases, these declarations will end up in the "regular" review process, requiring submission of the lengthier full notice filing, particularly if there is any complexity or perceived risk. The desired streamlining is expected to occur for low-risk transactions. Further, CFIUS is expected to increase review of, and enforcement actions with respect to, transactions that do not make a CFIUS notification.

Recent transactions: Grindr, PatientsLikeMe, TikTok and others

In a transaction that highlighted the reach of CFIUS in 2018, the U.S. President blocked, through executive order, the $117 billion hostile bid by Broadcom, a Singapore chipmaker, to acquire California-based Qualcomm, citing national security concerns in ordering both companies to immediately abandon the proposed transaction. This move came soon after CFIUS issued a negative recommendation. Pointedly, CFIUS expressed concern that

Qualcomm and, by extension, the United States, could be disadvantaged in the race to develop next-generation 5G wireless technology against rivals such as China's Huawei Technologies Co., the largest supplier of telecommunications network equipment and the second-largest maker of smartphones, which in May 2019 was added to a U.S. trade blacklist. The swiftness of the decision was broadly seen as the U.S. President leveraging escalating tension with China to send a clear message about foreign investment in American technology. In March 2019, CFIUS ordered a divestiture by a Chinese gaming company, Beijing Kunlun Tech Co. Ltd. ("Kunlun Tech"), of its interest in Grindr, LLC, a popular LGBTQ dating application, which includes a user's location and HIV status. In that transaction, CFIUS may have focused on the potential vulnerability to blackmail of military and intelligence officers whose data was available to the application. In April 2019, CFIUS forced a Chinese digital health company, iCarbonX, to divest its 2017 majority stake in PatientsLikeMe, Inc., a U.S. healthtech start-up which provides an online platform to help patients locate others with similar health conditions based on the collection of personal and health data. The PatientsLikeMe transaction was small at $100 million and neither that deal nor the Grindr investment had resulted in a CFIUS filing. In March 2020, President Trump issued an order requiring Beijing Shiji Information Technology Co., a publicly listed Chinese company, to divest its holdings in StayNTouch, Inc., which provides cloud-based software services for the hotel management industry, years after its initial investment in 2016, due to concerns over accessing hotel guest personal and financial data. CFIUS was authorised to implement measures to verify compliance with the order. Since the end of 2019, members of Congress have called on CFIUS to investigate the popular video-streaming app, TikTok, owned since 2017 by a Chinese parent, ByteDance, due to concerns over censorship of political protests in Hong Kong and the ability to amass personal data, particularly as a result of heavy use during the COVID-19-related lockdowns. The company is supposedly in mitigation discussions with CFIUS.

Areas to watch for future dealmaking

There are several areas to watch as CFIUS continues to evolve through future regulations: the definition of emerging and foundational technologies; the interplay with future export control legislation; and in light of the current global COVID-19 crisis, a sharper focus on supply chains, healthcare and pharmaceutical investments and acquisitions as potential TID US Businesses. Healthcare is included as "critical infrastructure" and accordingly, protecting the domestic supply chain of essential medicines, ventilators and protective equipment is paramount. Similarly, biotechnology is included as a "critical technology" such that deals with foreign investors in this industry in connection with vaccine development, testing and treatment could present CFIUS risk. The final rules further clarify that joint ventures located overseas between foreign and U.S. companies, "incremental acquisitions", bankruptcy sales and certain debt transactions by foreign lenders (where on a likely default, they would exercise control over a sensitive U.S. business or obtain certain sensitive information) may now fall under CFIUS review. Investors and companies should be aware that CFIUS may not review an initial investment but may decide to review an add-on investment or additional round of financing that results in materially different governance rights.

Transaction parties should be aware of a rapidly expanding sphere of what might constitute "national security" which could incorporate genetic information or sexual orientation to less technical, but nonetheless essential, supply chains. Technology and consumer companies may be unpleasantly surprised to find their transactions now within CFIUS' ambit, even years after an acquisition or investment. Additional proposed rules are being issued by CFIUS at the time of finalising this chapter that, among other things, would expand mandatory filings for non-passive investments in "critical technologies" by eliminating the sensitive industry nexus and tying these more closely to export control rules; therefore, investors and companies should closely monitor this space.

Antitrust

In connection with the antitrust aspect of transactions, 2019 saw more extensive scrutiny from the U.S. Department of Justice ("DOJ") and the U.S. Federal Trade Commission ("FTC"), the chief antitrust/competition regulators in the United States, of the technology sector's acquisition of nascent competitors and continued attention to "vertical transactions" with a counterparty's customers or suppliers. Towards that end, the FTC created a new Technology Enforcement Division to focus on technology mergers, which is reportedly reviewing Facebook's and Google's prior acquisitions to determine whether they were part of an anticompetitive strategy. The FTC and the DOJ also issued draft vertical merger guidelines in January 2020. In the run up to the U.S. Presidential election in 2020, candidates have been calling attention to the dominance of certain large technology companies and even calling for them to be broken up. In 2019, the DOJ blocked a proposed $360 million acquisition by Sabre Corporation of Farelogix, Inc., which was then cleared by a U.S. court in April 2020, only to be blocked by the UK Competition Authority, finally resulting in the termination of the deal in May 2020. The $85 billion purchase by AT&T of Time Warner was challenged by the DOJ as the first litigated vertical merger challenge in recent memory and ultimately dismissed on appeal with the D.C. Circuit Court in February 2019. The FTC went on to clear vertical mergers between *Staples/Essendant*, *Fresenius/NxStage* and *UnitedHealth/DaVita* over the minority objections of certain FTC Commissioners.

Another notable trend of 2019 was more activism on the part of state attorneys general, which is evidenced by the suits by certain attorneys general to prevent T-Mobile's $56 billion merger with Sprint, the third- and fourth-largest mobile providers, even though the DOJ and the FTC cleared it after requiring certain divestitures. A federal court rejected the states' claims and enabled the transaction to close. Finally, antitrust authorities are also monitoring no poach agreements among employers since issuing guidance in 2016 that they could be subject to criminal antitrust violations. Several state attorneys general once again disagreed with the DOJ over its permissive views on private litigation relating to no poach provisions in franchise agreements.

The year ahead

Any predictions regarding future performance of the M&A markets were upended by the outbreak of COVID-19. Hopes of maintaining momentum from 2019 were dashed in March 2020. In the aftermath of the COVID-19 outbreak, buyers are beginning to test their ability to terminate transactions for reasons relating to the outbreak and related government responses. For example, a prominent casualty of the COVID-19 pandemic was the $525 million sale of a majority stake in Victoria's Secret, the lingerie company, by L Brands to Sycamore Partners. Sycamore Partners claimed that L Brands had breached the transaction agreement by furloughing employees and closing retail stores. Rather than attempting to force the issue in litigation, the parties mutually terminated the agreement without the payment of any break fees or expense reimbursement. Another example where the parties mutually agreed to terminate without the payment of any fees was the proposed $6.4 billion all-stock merger between aircraft parts suppliers Hexcel Corporation and Woodward, Inc.

A number of other buyers involved in pending transactions that were executed prior to the COVID-19 pandemic are seeking to terminate deals by either arguing that an MAE has occurred in connection with the COVID-19 outbreak or that the sellers breached the interim covenant to operate in the ordinary course of business by taking extraordinary actions in response to the COVID-19 outbreak. The home goods retailer Bed Bath & Beyond filed suit against 1-800-Flowers.com, Inc. in response to a unilateral action taken by 1-800-Flowers to delay the closing of the $252 million purchase of the PersonalizationMall.com business for the stated purpose of determining whether an MAE had occurred. Although the transaction agreement did not contain a specific exclusion for pandemics from the definition of MAE, Bed Bath & Beyond maintains that no MAE occurred because the COVID-19 pandemic did not have a "disproportionate effect" on the target company, as often required by carve-outs to the definition of MAE in acquisition agreements. Another transaction that has resulted in litigation is the acquisition of dine-in theatre chain Star Cinema Grill by Cinemex Holdings USA, Inc.; Cinemex has subsequently filed for Chapter 11 bankruptcy protection. According to Star Cinema, Cinemex refused to close the transaction because of the COVID-19 pandemic. In this case, the MAE clause specifically excluded epidemics, pandemics and outbreaks from the definition, other than to the extent they had a disproportionate impact on the target. In the case of the proposed acquisition of Level 4 Yoga, a franchisee yoga studio, by CorePower Yoga, Level 4 Yoga filed suit against CorePower Yoga after CorePower Yoga alleged that, among other things, Level 4 Yoga had violated the covenant to operate in the ordinary course of business by shutting down its studios in response to government directives without seeking buyer's consent. Level 4 Yoga is seeking damages and legal costs, as well as a declaratory judgment that the purchase agreement remains in full force. We expect to see more such litigations arising out of pending transactions as the pandemic continues.

A heightened level of deal-related litigation is expected to continue until the global economies recover from the COVID-19 crisis. Potential purchasers may be looking at declining financial situations for themselves or for the target companies and rethinking whether to proceed with previously agreed-upon acquisitions. In the meantime, for any transactions that are entered into after the initial outbreak in March and April 2020, parties are expected to specifically address the pandemic in the context of the MAE definition, extend timetables in anticipation of regulatory agency delays and clearly define actions that a target may take in response to the outbreak without violating the interim covenant to operate in the ordinary course of business. Despite Delaware's landmark *Akorn, Inc. v. Fresenius Kabi AG* decision in 2018 finding the occurrence of an MAE, it is unlikely that the COVID-19 pandemic will ultimately result in many additional findings of an MAE in order to provide a valid termination right to a buyer because of the unique facts of the *Akorn* case. We also expect to see an increase in litigation against Boards of Directors and management in connection with second-guessing how companies severely affected by COVID-19 have responded to the crisis, from decisions relating to financings, entering or terminating strategic transactions to handling communications to employees, customers and shareholders on issues affecting public health and safety.

The impact of COVID-19 on future M&A transactions is continuing to unfold. Slowing economies in key regions due to COVID-19, stricter foreign investment review regimes, uncertainty over the impending U.S. Presidential election and the spectre of an escalating trade war continue to concern investors. The election may offer competing visions for how to drive sustainable and inclusive economic growth, with special attention to struggling private equity-backed retail and healthcare companies as well as proposals seeking to "rein in" certain aspects of the private equity industry. After a rough start, government agencies have transitioned to virtual working along with the court systems, and all parties are now looking ahead to staged reopenings of the economy implementing varying restrictions. Similarly, as transaction parties come to resign themselves to the "new normal" for the foreseeable future, they are beginning to learn to source, diligence and fund potential transactions without physical meetings and site visits and using new technological tools of collaboration and communication to bridge the gaps. Nonetheless, given these constraints and expected delays in obtaining antitrust and other regulatory approvals, transactions will take longer to execute. This challenging environment casts a spotlight on the potential for disruptions in upstream supply chains and downstream end-markets as a part of business and legal diligence for new transactions. Add-on and roll-up transactions and acquiring carved-out assets from strategics are likely to continue as a sizeable portion of overall deals. The duration of the pandemic as a severe global public health threat without an effective treatment or vaccine will significantly determine the duration and severity of the economic downturn. While it is still relatively early in what could be a protracted period of an economic recession, the sellers' market is in the midst of flipping to a buyers' market that seeks to shift risk of further deterioration of the business to sellers. Transaction parties are expected to try to protect themselves from the uncertainty around valuation and declines in the business through more creatively structured transactions involving minority/toehold investments, private investments in public equities ("PIPEs"), earn-outs, seller notes, call options, convertible/hybrid instruments, increased management rollover amounts, reverse termination fees for failure to receive regulatory approvals, and possible specialty representations and warranty insurance products. Looking ahead, opportunistic investors, including sponsors, will seek bargain-priced assets in weakened sectors such as travel, leisure and mass transportation, while sponsors on the sell-side anticipate holding portfolio companies longer, including through transfers from funds nearing end of term and GP-led secondaries and supporting them during the downturn through recapitalisation and equity infusions, while they wait for public markets and other exit avenues to recover. As a result, distressed M&A transactions are expected to comprise a significant percentage of transactions in the next cycle, as happened during the 2008 global financial crisis. Investors will also be exploring sectors positioned for growth resulting from COVID-19 such as telemedicine, biotech, virtual collaboration platforms, e-commerce, logistics and supply chains, and food security and data security services, which may well continue to mature in the post-COVID world.

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