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TICK, TICK . . . BOOM!: M&A IN 2021 AND WHAT TO EXPECT IN 2022

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In the Heights: Introduction

Despite a significant decrease in M&A activity in 2020 due to the onset of the pandemic, the second half of 2020 showed signs of recovery in deal activity. That momentum carried into 2021 and sustained what became a historic year for deal making. With the equity markets posting all-time highs, interest rates at record lows, and economic growth recovering from the pandemic-induced downturn, the stars aligned for robust M&A activity this past year.

According to FactSet's *Flashwire US Monthly*, for the 12-month period ended October 31, 2021, the total number of deals in the United States was up over 40% year-over-year (20,283 compared to 14,464 at the same time in 2020). For the first time ever, aggregate deal volume exceeded $5 trillion in 2021.

After largely sitting on the sidelines in 2020, private equity acquirers had record amounts of dry powder to put to work and in 2021 they did just that. In addition, the hundreds of special purpose acquisition companies ("SPACs") that went public in 2020 and 2021 were searching for acquisition targets. Plentiful financing on excellent terms with low interest rates provided acquirers with capital necessary to supplement robust balance sheets, while public strategic buyers were able to use their own stock, with many trading at or near all-time highs, as currency in their deals.

Despite the blazing pace of deal activity, the market did show signs of moderating a bit as the year-end approached. In addition, there were relatively few megadeals—above $25 billion—for a year in which so many deals were happening in so many sectors.

With so many companies trading at record-high share prices in 2021, CEOs and

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their boards had the confidence, and the firepower, that is the "jet fuel" of deal making. This, coupled with pressure from activists, led to record activity levels of transformative deals.

Night of the Kings: SPACs

During the first half of 2021, it was nearly impossible to avoid hearing about the latest craze in mergers and acquisitions. Whether it was Shaquille O'Neal, Colin Kaepernick, or the former president of the United States, everyone seemed to have involvement in the SPAC business. Special Purpose Acquisition Companies, or "SPACs," are "blank check" companies that raise proceeds from public investors by way of an IPO for the purpose of seeking a business combination. The proceeds raised through the IPO are typically held in trust until the ultimate merger or business combination is completed, and the public investors hold redemption rights with respect to those proceeds. The appeal of SPACs is clear—the SPAC completes the IPO process initially as a blank check company without a reportable operating company. The SPAC then merges with a private target company, providing an unconventional means to take the target company public with additional capital and liquidity.

In 2020, SPACs took the market by storm, raising over $83 billion of gross proceeds through IPOs. According to FactSet, SPACs accounted for half of all IPOs in 2020. But calls to deem 2020 "the year of the SPAC" were clearly premature. In the first quarter of 2021 *alone*, 312 SPACs raised $96.4 billion through IPOs.

The music may soon be stopping—or at least slowing down—with respect to the SPAC frenzy, however. As with any phenomenon that generates large amounts of excitement and attention, the proliferation of SPAC IPOs and subsequent business combinations has attracted the attention of regulators and legislators alike. In April, the staff of the SEC issued guidance regarding the ways in which SPACs account for warrants—a common feature of SPAC structures. The SEC has continued to express concern about disclosure to investors and the divergent interests between the SPAC's directors, officers, and sponsor on the one hand, and the public investors on the other hand. In September, the SEC issued further guidance on certain SPAC accounting treatments, which could even require restatement of a SPAC's financial statements. In addition, the typical time period for the SEC to review and

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comment upon SPAC merger proxy statements has significantly lengthened. With respect to Congress, the House has drafted legislation targeting the potentially lucrative arrangement between SPACs and their sponsors. Senator Elizabeth Warren of Massachusetts explicitly called upon the SEC to investigate the so-called "Trump SPAC" for misleading shareholders and disclosure omissions, and the Trump SPAC disclosed such an investigation by the SEC and FINRA in December.

With these headwinds, it is no wonder that the number of SPAC IPOs have fallen dramatically since their peak in the first quarter. As of September 30, only 106 SPACs have gone public, raising approximately $20 billion, since the frenzy of IPOs in the first quarter of 2021.

Regulatory and legislative concerns aren't the only headwinds facing the SPAC market. While the prospect of becoming a public company in a shortened time frame is appealing, target companies often struggle with adjusting to being a publicly-reporting company and having the necessary procedures and personnel in place. SPACs also tend to target early-stage companies that may struggle with proof of concept issues that a mature public company would be well beyond. For instance, the former CEO of Nikola Corp. was indicted in July for defrauding investors based on statements and materials that were allegedly designed to mislead investors about the development of Nikola's products.

A final issue with the SPAC market relates to the actual process of combining with a target company. In a typical SPAC transaction, there is a private placement in public equity ("PIPE") component, in which certain institutional investors and investment funds agree to purchase shares of the SPAC at the same time the business combination is consummated. The purpose of the PIPE is two-fold—it provides a market-test of the value of the target company, and it guarantees the target company a specified amount of capital in case a large number of shareholders elect to redeem their shares. In recent months, however, the market for PIPE investors has dried up significantly, requiring creative approaches by which the SPAC can guarantee capital for the target company at closing.

Looking ahead to 2022, we expect to see continued regulatory and legislative scrutiny. 2022 could, however, prove to be a banner year for SPAC business combinations, now that so many have gone public. Traditionally SPACs have a two-year time frame by which they must complete a business combination or return proceeds to their shareholders. As of September 30, 2021, there were 458 SPACs looking for target companies and 318 of those SPACs had less than 18 months to complete the business combination. As these SPACs move toward a business combination with a private target, they'll be looking to the PIPE market to unfreeze or else come up with creative solutions for guaranteeing capital to the target, particularly in light of the increased level of redemptions that SPACs have realized over the past few months.

We Broke Up: Companies Focus on Core Businesses

Carve-out activity in the first several months of 2020 started strong and, if not for the COVID-19 pandemic chilling M&A activity across the board, likely would have continued unabated. Instead, many deals that were shelved during the first half of 2020 came back to life during the more favorable deal environment of 2021. Buoyed by strong economic conditions and pressured by activist investors emphasizing an increased focus on core businesses, public companies, and in particular certain well-known international conglomerates, announced large transformational divestitures and/or spin-offs in 2021. Activists have seemed to favor these types of transactions as a means of focusing on simplicity and streamlined business models, pushing the companies in which they take positions to prune their portfolios in an effort to maximize and unlock shareholder value. This activist pressure was seemingly more pronounced in 2021 than in years past, given that numerous activists were able to accumulate toe-hold positions in public companies at depressed market prices during 2020, despite somewhat of a hiatus of activist campaigns in the first half of 2020.

According to Deloitte's Divestitures M&A Update for Q3 2021, U.S. divestitures for the third quarter were up 6.6% compared to the same period last year and up 8.4% compared to the second quarter of 2021. Notable divestiture transactions of the past year included October's announcement that Chubb had agreed to acquire Cigna's life, accident, and supplement benefits business in seven different countries for $5.75 billion and more recently in December, Gray Television closing its acquisition of Meredith's local media group, including 17 television stations in 12 local markets for $2.8 billion (after which Meredith will be acquired in full by Barry Diller's IAC for $2.7 billion).

Outside of typical divestiture activity, 2021 also saw the announcement of significant spin-offs and breakups of multinational corporations, in what *Forbes* termed "Death to Conglomerates." In November alone, General Electric, Toshiba, and Johnson & Johnson announced plans to break up their sprawling empires into separate operations. While each signals a potential change of the tides, GE's announcement in particular may be a signal of things to come. GE, like many other of the world's largest corporations historically, pursued an aggressive strategy of growth through acquisitions. Under the leadership of legendary CEO Jack Welch, GE expanded substantially and diversified its portfolio across numerous verticals. However, precipitated by the near-collapse of GE Capital during the financial crisis, GE has spent the better part of the last decade divesting assets in an effort to pay down its debt load. November's announcement appears to be the culmination of those efforts and may provide a helpful blueprint for similarly diversified companies that are seeking to streamline in the future.

Chaos Walking: Unprecedented Legislation and Rulemaking

This fall, the House Rules committee unveiled the Build Back Better Act (the "BBBA"). Along with allocating significant funds to infrastructure and to fight climate change, the BBBA also includes sweeping proposed tax reform that is likely to have a significant impact on M&A activity. Among the proposed changes are a surcharge on income in excess of certain specified thresholds, an expansion of net income tax and "surcharges" on individuals, trusts, and estates with modified adjusted gross income above certain amounts.

Not surprisingly, the year-end saw a flurry of activity as selling companies and selling shareholders alike sought to close transactions during the calendar year in order to take advantage of the current tax regime prior to the likely implementation of tax reform in the new year.

While anticipated tax reform created a strong incentive to get deals done before the year's end, other legislative and regulatory factors created strong headwinds for deal activity. 2021 marked a significant change in approach and priority at the Federal Trade Commission ("FTC"). Led by new chair Lina Kahn, the FTC has taken a more aggressive stance to reviewing and challenging deals. According to a Kahn-authored memo issued to FTC staff in September, the FTC will begin reviewing deals holistically, rather than through its conventional means of market-based antitrust concerns.

The regulatory landscape has become even more uncertain since the FTC's pronouncement in August that it would begin issuing "Pre-Consummation Warning Letters" to transaction parties for deals that it could not fully investigate within the 30-day HSR waiting period. Companies that choose to consummate a transaction after receipt of such a letter do so "at their own risk" as the FTC "may subsequently determine that the deal was unlawful." And, in the second half of the year, warning letters were issued in connection with numerous transactions, across several industries from oil and gas to healthcare. In practice however, M&A parties have largely proceeded to close their respective transactions despite these warnings.

Increased legislation and rulemaking in 2021 was not limited to the United States. We also saw a substantial uptick in the activity of foreign direct investment and competition regimes abroad. In the United Kingdom, the Competition and Markets Authority took interest in, and issue with, a number of notable transactions. In November the CMA ordered Facebook (n/k/a Meta) to unwind its $400 million 2020 acquisition of GIF database and search engine GIPHY, despite the fact that GIPHY does not generate any revenue in the UK. The decision is a reminder for transacting parties and practitioners alike that the CMA's jurisdiction is far-reaching. As of the date of this article, the CMA continues to probe Nvidia's proposed $40 billion acquisition of UK-based Arm over antitrust concerns. That transaction has also come under fire by the FTC, which sued to block the deal in December. [See elsewhere in this issue.]

International competition authorities also appear to be cooperating closely in connection with merger reviews, enabling regulators to rely on the legal toolboxes of their international counterparts for assistance. Cooperation appears to be heavily focused on certain key sectors, including pharma and tech. This collaboration, however, does not guarantee that authorities will necessarily find common ground in their approaches to challenging transactions as evidenced by differing views on a number of deals. These include Aon and Willis Towers Watson's proposed merger and Visa and Plaid's proposed tie-up, both of which were terminated in 2021 under regulatory pressure from European authorities (the CMA and EC, respectively) despite going unchallenged by U.S. regulators.

We are also witnessing an increase in activity from various foreign direct investment ("FDI") regimes. FDI regimes tend to be less transparent than their competition regime counterparts, making it more difficult to determine in each instance whether FDI clearance will be required in a given transaction. FDI regimes also differ markedly from jurisdiction to jurisdiction, which can add significantly complexity in the context of cross-border deals.

The regulatory landscape for M&A activity is a complicated one that will require significant planning and resources for transacting parties to navigate properly in 2022 and beyond. Regulatory scrutiny is one of a number of factors that is causing deals to take longer to complete than ever before. It is essential that M&A parties work with financial, legal, and other advisors with proper regulatory and, where applicable, cross-border, experience to help them navigate these choppy waters and negotiate appropriate provisions in acquisition agreements. All of this also emphasizes the critical nature that lobbying will play for some companies going forward, and the importance of effective monitoring of the ever-changing regulatory landscape, both in D.C. and abroad.

The Little Things: Softening of the RWI Market

Representation and warranty insurance ("RWI") has become ubiquitous in private transactions. Like other operators in the M&A space, RWI insurers had to adjust to the heavy deal flow of 2021 and the pandemic-necessitated changes coming out of 2020. Given the significant number of market participants, we are seeing that insurers have become more selective in the policies they underwrite and those policies have become increasingly stringent. Quotes offered have become more detailed and technical, oftentimes providing specific feedback on the representations and warranties in the underlying agreement for which they are offering coverage.

In the wake of 2020, a year in which insurers saw an unprecedented number of claims made as a result of the onset of the COVID-19 pandemic, current policies include significant exclusions and often qualify or otherwise read-out certain representations in their entirety. Notwithstanding the scope of coverage lessening, pricing for RWI has risen due to an increase market demand for insurance, with premiums for RWI policies on the rise.

Given the increase in costs for coverage that is decreasing in scope, it should come as no surprise that buyers and sellers are starting to bypass the use of RWI in favor of traditional indemnity regimes in their private transaction agreements. We expect this trend to continue into the new year, at least until the RWI market reaches a healthy equilibrium once again.

No Sudden Move: State of Play at the Delaware Court of Chancery

At the nation's preeminent court of corporate jurisprudence, 2021 represented a year of important changes. In May, the Honorable Kathaleen St. J. McCormick was sworn in as Chancellor for the Delaware Court of Chancery. McCormick is the first woman to lead the Chancery Court, taking over for Chancellor Andrew Bouchard, who stepped down prior to the conclusion of his 12-year term. Chancellor McCormick's former position of Vice Chancellor was filled by Lori W. Will, a former Wilson Sonsini and Skadden, Arps attorney who previously clerked for then-Vice Chancellor Leo Strine.

Meanwhile, Vice Chancellor J. Travis Laster was nominated for reappointment to his position in October. First appointed in 2009, Vice Chancellor Laster is the Court of Chancery's longest-serving judge currently on the bench and has made an indelible impact on Delaware corporate law, penning a number of landmark decisions during his tenure.

The Chancery Court also handed down several interesting and influential decisions over the course of 2021. In February, then Vice Chancellor McCormick issued a decision enjoining The Williams Companies from continued use of a poison pill that Williams had implemented in response to a significant drop in its stock price due to the effects of COVID-19 and the impact of a pricing war amongst oil producing countries. Among other things, the Court's decision held that the proper standard for assessing adoption of poison pills is that from *Unocal v. Mesa* (intermediate enhanced scrutiny) rather than the business judgment rule, a more deferential standard.

In May, in connection with Brookfield Property Partners' 2018 acquisition of GGP, the Court of Chancery dismissed a class action brought by GGP stockholders against certain directors and officers of Brookfield. The stockholders had alleged that Brookfield, which owned over 35% of GGP's common stock at the time of the deal, controlled GGP and therefore owed fiduciary duties to GGP stockholders. The Court found that the plaintiffs failed to properly show minority control, reiterating the high burden of showing that a minority holder exercised control at the time of a transaction. Interestingly, this decision stands in contrast to other recent Delaware holdings relating to minority control, suggesting that such decisions will largely be based on specific facts and circumstances.

Amidst the wave of post-deal litigation stemming from the impact of COVID-19, the Chancery Court also rejected a handful of buyers' claims that targets have suffered material adverse effects. In each of *Bardy Diagnostics, Inc. v. Hill-Rom, Inc.* and *Snow Phipps Group, LLC v. KCAKE Acquisition, Inc.,* the Court's findings reiterated the high standard for finding an MAE, only present in its *Akorn* decision to date. The Court's November decision in *In Re The Boeing Company* provided a helpful roadmap for stockholders seeking to bring duty of oversight claims. In *Boeing*, the company's stockholders adequately pleaded that certain Boeing directors had failed to establish a reporting system in connection with safety issues surrounding the company's 737 MAX planes and the resulting tragic crashes during 2018. Despite the Court acknowledging the difficulty plaintiffs face in bringing duty of oversight actions, Boeing's stockholders were able to sufficiently plead and survive a motion to dismiss.

We Need to Do Something: ESG as the Next Big Thing in Transactional Behavior

In recent years, environmental, social and governance ("ESG") considerations have become an increasing important focus inside corporate boardrooms. To date, that has yet to have the expected impact on M&A activity. According to a recent survey of M&A executives by Bain & Company for their 2022 M&A Report, dealmakers ranked ESG as their lowest priority, but they expect that to change in the very near future. From diligence, to valuation, to post-closing integration, ESG is likely to take on an increasingly important role in how dealmakers view, structure, and consummate transactions. We began to see this in 2021 as ESG started to take on an ever greater role, becoming a catalyst for M&A transactions and changes in the boardroom across numerous sectors.

In the oil and gas industry for example, Royal Dutch Shell was the target of significant public scrutiny concerning ESG this year. First, in May a Dutch court ordered Shell, by means of its corporate policy, to reduce its CO2 emissions by 45% by 2030. The ruling, which was in response to a 2019 lawsuit brought by certain international public interest groups including Greenpeace, would accelerate Shell's already ambitious climate goals, which previously targeted reducing CO2 emissions 20% by 2030, 45% by 2035, and 100% by 2050. In the wake of the court's ruling, in July Shell, through its renewable unit Shell New Energies U.S., announced the planned acquisition of clean energy company Inspire Energy Capital. The deal, which closed in September, is expected to accelerate Shell's mission to drastically reduce CO2 emissions and promote clean energy amongst its customers and suppliers.

Food and consumer products companies have also expressed a desire to prioritize ESG as a driver for M&A. For many of these businesses, sustainability has become a hallmark of their respective acquisition strategies. In April, Olam International, the Singapore-based agri-food business, agreed to purchase U.S. spices and seasonings business Olde Thompson from private equity firm Kainos Capital for $950 million. In connection with the deal, Olam touted how Olde Thompson would help it continue to deliver sustainable, natural, value-added food. Notably, Olde Thompson's facilities utilize solar panels to provide 75% of its energy requirements.

2021 also saw an increased focus on "clean" or "green" de-SPAC targets, many of whom were targeted by SPACs with investment mandates to pursue targets in areas including clean energy, renewables, and sustainability. Numerous of these SPACs reached agreements in 2021, including smart energy storage company Stem's April merger with a clean energy-focused SPAC and electric charging network company EVgo's July merger with a climate-focused SPAC. But for each ESG-centric SPAC that announced a merger in 2021, there are countless others that continue to search for an appropriate target to bring public, suggesting that the push to bring ESG-focused companies to the public markets will continue in 2022 and beyond.

According to Refinitiv, climate-change deals tripled to more than $164 billion in the first 11 months of 2021. Clearly there is much more to come.

The World to Come: Looking Ahead to 2022

After a historic year for M&A, the conditions for continued activity appear to be present. The stock market continues to rise, the Fed has yet to raise rates (though recent indications suggest that may change), hundreds of SPACs remain without a target and, despite the discovery of new variants of COVID-19, continued scientific progression has enabled much of the world to safely reopen their economies. Despite these favorable conditions, however, the road ahead is not entirely clear. The regulatory landscape, both in the United States and abroad, is characterized by numerous unknowns that have the potential to slow deal activity. Nevertheless, 2022 is likely to be another strong year for deal making that will be active across all geographies and sectors. It is likely that M&A lawyers will be busy again in 2022.