2021 Insights

Skadden

A collection of commentaries on the critical legal issues in the year ahead.

’21

Editorial Board

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US M&A Outlook: Rebounding Market Fuels Optimism for Deal Activity in 2021

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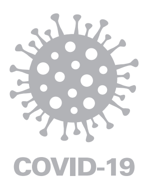
After nearly a decade of growth, global M&A activity in the first quarter of 2020 was down 39.1% by deal value year over year — comparable to levels seen in the first quarter of 2008, in the midst of the financial crisis. The chilling effects of the COVID-19 pandemic in the first half of the year translated to a significant backlog of M&A transactions. Approaching the end of 2020, however, dealmaking returned in full force, despite the ongoing human challenges imposed by the pandemic. Coupled with cautious optimism around the effects on dealmaking from the new administration, record special purpose acquisition company (SPAC) capital formation, favorable financing trends and the likely continued benign interest rate environment for the foreseeable future, we believe that evolving conditions support a strong 2021 for U.S. M&A.

The dramatic decline in M&A activity around the globe in the early part of the year was largely attributable to the staggering effects of the pandemic, including the restrictive public health measures many governments worldwide adopted in response to the crisis. The U.S. M&A market suffered one of the steepest declines in activity of any region in the first six months of the year, with U.S. deals declining by approximately 70% compared to the same period in 2019 and representing just one-third of global M&A by deal value (down from over 50% in 2019).[1] During the same period, global M&A activity declined 53% by aggregate deal value and 32% by deal volume, year over year.

In the second half of the year, U.S. deal activity jumped more than 400% by value between the second and third quarters (a 38% increase year over year), and U.S. M&A once again represented nearly half of global deal value for the full year, in part as a result of pent-up demand from the early stages of the COVID-19 pandemic. Large deals (those valued at $5 billion or more) had a resurgence in the second half of the year, with seven mega-deals ($10 billion or more) announced in the third quarter. Eight of the 10 largest deals by transaction value announced in the U.S. in 2020 were in the technology and life sciences sectors, showing the resilience of these sectors in the face of the pandemic.

Selected 2020 Trends



Terminations and Withdrawals

COVID-19 resulted in a spike in deal withdrawals and terminations in late March 2020 globally, with many acquirers having buyer's remorse as business deteriorated for targets as a result of the pandemic. By the end of June 2020, more than $100 billion of U.S. M&A deals had been terminated. Interestingly, the value of terminated deals during the first half of 2020 was only slightly up from the same period in 2019 ($94.8 billion) and down from the same period in 2018 ($152.64 billion), indicating that the aggregate effect of COVID-19 on deal terminations may not have been as significant as initially suspected. Some delayed or disrupted transactions ultimately moved forward with adjustments to pricing terms.

1 Sources for the data in this article are: Mergermarket M&A Report, Bloomberg, Deal Point Data, S&P Global Market Intelligence, SPACInsider.com, Lazard, Activistmonitor and PitchBook.

Unsurprisingly, M&A practitioners adapted by introducing explicit contractual provisions to allocate deal risk resulting from COVID-19. While a limited number of transaction agreements signed in February 2020 (such as the agreement between E*Trade and Morgan Stanley) reflected a "pandemic exception" to the definition of material adverse effect (MAE), once the effects of the COVID-19 pandemic became apparent, MAE provisions routinely began to clearly and specifically exclude effects resulting from the outbreak or spread of COVID-19. Interim operating covenants now regularly provide some degree of flexibility for targets in responding to the pandemic, for example, including actions necessary to protect the health and safety of employees or others having business dealings with the company. However, the specific details and general scope of such flexibility are varied and the subject of significant negotiation between the parties, as alleged breaches of these covenants are often the basis acquirers assert when seeking to walk away from a signed deal. We expect practitioners to continue to allocate pandemic risk in 2021 and beyond.

Biden Administration

In the U.S., the new administration's impact on M&A is still an open question. Many dealmakers had been taking a "wait-and-see" approach; however, now that the results of the election are known and the Democratic Party will control both chambers of Congress, many are cautiously optimistic about the effects of the new administration on U.S. M&A, particularly if tight congressional majorities and macroeconomic trends restrain dramatic regulatory changes. Many M&A professionals expect that there may be regulatory developments, in areas such as antitrust and national security, that could have some impact on, but are unlikely to fundamentally change, the overall dealmaking environment under the new administration.

How aggressive the federal antitrust agencies are likely to be will largely depend on whether President Biden appoints moderate or progressive enforcers. Typically, change comes more slowly at the Federal Trade Commission (FTC) than the Department of Justice (DOJ) because the president has to wait for openings on the five-member commission before new ones can be appointed. However, due to the recent announcements that Republican Chairman Joseph J. Simons will be resigning on January 29, 2021, and Democratic Commissioner Rohit Chopra will be nominated to head up the Consumer Financial Protection Bureau, President Biden will have at least two slots to fill and can thereby flip control of the FTC to the Democrats. (See "Transition From Trump to Biden May Bring Less Change to Antitrust Enforcement Than Expected.")

In terms of industry-specific enforcement, federal agencies and the Biden campaign have indicated that the pharmaceutical and health care industries may face increasing scrutiny from antitrust enforcers under the new administration. In recent months, the technology sector, particularly where some of the industry's largest players are concerned (further highlighted by the antitrust lawsuits filed in recent months against Google and Facebook by the DOJ and FTC, respectively), has faced bipartisan scrutiny that is expected to continue under the new administration.

Similarly, the enhanced oversight of Chinese takeovers of U.S. companies by the Committee on Foreign Investment in the United States (CFIUS), which was a priority under the Trump administration in 2020, is expected to continue under the Biden administration (though the tone with respect to Chinese investors seems likely to soften under the new administration). (See "US-China Trade and Enforcement Issues: What's Next?")

Although President Biden proposed a number of fundamental changes to the tax code during his campaign — including, most notably, significant increases to tax rates — even with a Democratic-controlled Senate, drastic changes to corporate tax law may be unlikely until the economy recovers from the effects of the pandemic. (See "Growing Complexity in the Tax Aspects of Transactional Negotiations.")

Year of the SPAC

2020 was a banner year for SPACs, and 2021 shows no sign of slowing. SPAC IPOs in 2020 left over 200 post-IPO SPACs actively searching for targets, which most are required to find within the first two years after the initial public offering (IPO). The popularity of SPAC transactions had been gradually increasing in recent years, but the onset of the COVID-19 pandemic, coupled with perceived inefficiencies in the traditional IPO market, appears to have acted as a catalyst to the meteoric rise in the popularity of SPACs. (See "The Year of the SPAC.")

In 2020, SPACs raised over $75 billion, in the aggregate, across 247 completed IPOs (compared with $12.01 billion raised across 59 IPOs in 2019). The average SPAC IPO size increased from $230.5 million in 2019 to more than $334.8 million. In July 2020, Pershing Square Tontine Holdings, Ltd. became the largest SPAC following its IPO, raising $4 billion. The record-breaking number of SPAC IPOs led to several other 10-figure transactions in 2020, including Opendoor Labs, Advantage Solutions and QuantumScape Corporation.

This increasingly competitive market for business combination targets has changed the way that de-SPAC transactions are negotiated and structured, however, with potential targets running competitive sale processes that resemble those of more traditional M&A auctions. As a consequence, there has been a growing focus by potential SPAC transaction partners on the SPACs themselves, including the amount of cash the SPAC raised in its IPO and holds in trust, the reputation of the sponsor or sponsors, actions SPAC sponsors are willing to take to reduce or restructure their promote, and the ability of the SPAC or its sponsors to raise additional capital (*e.g.*, pursuant to a concurrent private investment in public equity, or PIPE). Some sponsors have even agreed to pre-IPO forward purchase arrangements

— which represent firm commitments to make additional equity investments in the post-business-combination merged company before knowing the identity of the target. There is little doubt that SPACs are likely to be a meaningful driver of activity in 2021.

Shareholder Activism

The pandemic muted the pace of shareholder activism globally in 2020, with 24% fewer campaigns initiated during the first three quarters of the year, compared with the same period in 2019. This decrease in activity (during a time when shareholder activism was otherwise expected to increase) was undoubtedly due in large part to activist concerns regarding the optics of opportunistically undertaking campaigns amid pandemic-related market volatility, while boards and management teams were focused on trying to save their businesses and protect their employees' health and safety. Those who participated in activist campaigns largely shifted their attention in the first half of 2020 from M&A objectives to changes to boards and management as well as operational improvements — only 34% of global activism campaigns launched during the first half of the year featured M&A objectives (down from approximately 47% for the same period in 2019).

As U.S. deal activity began to increase in the third quarter, however, activists began to again focus on M&A objectives. While U.S. shareholder activism for the third quarter remained down overall (64% lower than in the third quarter of 2019), a rebound in activist campaigns occurred in the fourth quarter, as M&A activity levels continued to recover from their COVID-19-related collapse. Shareholder activism in the U.S. is expected to continue to pick up during the 2021 proxy season as the economy stabilizes and M&A activity rises toward pre-pandemic levels.

Private Equity

U.S. private equity deal activity experienced a sharp shock toward the end of the first quarter when the COVID-19 pandemic derailed sponsor exit processes. However, the last few months of 2020 showed a strong rebound, with the promise of continued acceleration of M&A involving financial sponsors well into the new year. Many of the transactions that were put on hold in the first and second quarters were reactivated by the end of the third quarter, and sponsor buyout activity by aggregate deal value rose year over year for that quarter. By the end of the year, U.S. private equity deal activity saw 5,309 transactions worth a combined $708.4 billion close — down 3.4% by deal count and 7.3% by aggregate deal volume compared to the same period in 2019. But the momentum gained during the second half of the year indicates dealmakers are bullish heading into 2021.

Through the end of last year, there were also fewer private equity exits compared with 2019, though several significant exits via IPOs helped to buoy the aggregate exit value for the year (which ended up from 2019) as capital markets begin to recover as well. Following the astonishing boom in fundraising by SPACs, together with their increasing popularity as M&A counterparties for private targets, some private equity firms are beginning to see SPACs as a way to employ dry powder, with some general partners becoming SPAC sponsors and others agreeing to exit portfolio company investments via de-SPAC transactions.

Technology M&A

Technology M&A continued to be strong in 2020, as the level of the pandemic's impact on the sector was less severe than on other industries. Deals in the technology sector were the largest segment of deal value both globally and in the U.S.: Technology deals made up approximately 19% of all global deals and 28% of all U.S. deals. While many other sectors were down in M&A activity in the U.S. in 2020, technology M&A was up 57% from 2019. The largest U.S. deal in 2020 in the technology sector was AMD's acquisition of Xilinx for $35 billion. The strength of technology M&A can largely be attributed to the continued demand for technology products. For example, the number of fintech M&A deals accelerated in 2020, no doubt buoyed in part by the shift in consumer behavior away from traditional in-person methods and toward digital financial technologies. The largest digital health technology deal ever, Teladoc's acquisition of Livongo, was completed in 2020, and there is likely to be further M&A activity in the digital health technology space as a result of the pandemic continuing to push provider appointments with patients onto digital platforms.

We expect a high level of technology transactions to continue into 2021, as the pandemic has not changed the factors that previously made the space attractive and innovations in technology abound. Additionally, the pandemic has accelerated remote working and consuming trends, which will lead to additional combinations between technology companies and companies in more traditional sectors. That being said, as noted above, the impact of antitrust enforcement that is expected to continue in this sector will remain a critical factor in assessing the feasibility of and negotiating technology M&A deals.

Associate Alexandria L. Robertson contributed to this article.

2021 Forecast for UK M&A and IPOs: Delayed Gratification?

Many commentators predicted a boom in M&A and initial public offerings (IPOs) in the U.K. in 2020, a year that proved making predictions is a risky business. As we enter 2021, however, there are good reasons to believe that the worst of the pandemic will soon be behind us and we can be optimistic about the markets again. Strong signs indicate an appetite for large mergers, and the trillions of dollars held by fund managers set the stage for a revival of the IPO market.

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Global M&A got off to a good start in 2020, with the €17.2 billion buyout of ThyssenKrupp's elevators business by an Advent- and Cinven-led consortium in late February 2020 and Aon's $30 billion acquisition of insurance broker Willis Towers Watson 10 days later. By the end of the quarter, however, the effects of the pandemic were being felt. Activity was down 35.3% by value[2] from the previous three months.

The slump was even more pronounced in the second quarter, when Virgin Media's $12.6 billion merger with O2 was the only deal worth more than $10 billion in Europe. Overall, global M&A volume fell to $318.6 billion in the second quarter, the lowest level since 2003, with Europe accounting for $66 billion. However, volume rebounded in the third quarter, reaching $785.6 billion globally and springing back to $189 billion in Europe.

The U.K. IPO market struggled all year. At the end of February 2020, the owners of IQ Student Accommodation, who were reported to have been considering an IPO, opted instead to sell the company to Blackstone for $6.2 billion. And that was before the global health crisis. By November 2020, there had only been 17 IPOs all year on the London Stock Exchange (LSE), according to Barclays — seven on the Alternative Investment Market and 10 on the Main Market. Of the 17 IPOs, 12 priced post-October 2020, demonstrating how much activity was skewed toward the end of the year. That was a 40% decline from 2019, which itself saw the fewest listings since 2009. Only two companies achieved IPO valuations above £1 billion ($1.36 billion) during this period: smart meter maker Calisen in February 2020 and The Hut Group, an e-commerce company, in September 2020. The Hut Group IPO alone accounted for 40% of total U.K. IPO volume for the year.

Notably, and possibly portentously, The Hut Group came to market with an unorthodox governance arrangement (including a dual-class share structure), such that it was only entitled to a standard, as opposed to a more prestigious premium, listing. Difficulties faced by the LSE in attracting and retaining listings, in particular for high-growth, tech and founder-led companies, has triggered a review by the U.K. government of the U.K. Listing Rules. The LSE and the City of London are encouraging an overhaul by looking at issues including minimum free float requirements and dual-class share structures. A report of the review is due in the first few months of 2021.

Given a rollercoaster year for M&A and a poor showing for IPOs in 2020, why be optimistic for 2021?

First, M&A markets seem to be recovering, as evidenced by the turnaround in third-quarter numbers and the strong finish to the year. The fourth quarter started well, with the $9 billion acquisition of the Asda supermarket chain by

2 All M&A value data sourced from Refinitiv.

the entrepreneurs Zuber and Mohsin Issa and TDR Capital being announced in October 2020 and the $44 billion purchase of financial data provider IHS Markit by S&P Global in November 2020. The final months of 2020 also saw takeover bids for Codemasters Group Holdings plc, among others. The end result was that the value of European M&A for 2020 reached $785 billion, which represented a healthy 29% increase over the $607 billion for 2019.

Second, while IPOs were scarce in 2020, equity capital-raising was not. The Pre-Emption Group, which represents U.K. institutional investors, relaxed its guidelines in April to give listed companies greater flexibility to issue new shares, and a flurry of issues followed. A survey by financial services firm Goodbody showed that as of October 30, 2020, 463 LSE-listed companies had raised a total of $35 billion of new capital during the year, the highest level since 2009. In most cases this funding came from existing shareholders, but a number of companies participated in high-profile PIPE (private investment in public equity) deals, with publicly traded Aston Martin, Costain, SIG and Saga each attracting private capital.

These equity raises provided existing companies with liquidity to see them through the pandemic. If many businesses stabilize, there will be less demand for secondary issues, and equity investors with capital to deploy will be on the lookout for new companies that may pursue IPOs in 2021. The success of the Hut Group IPO — the company's valuation rose from $7.3 billion at the time of its offering to $10.4 billion by year-end — should make investors more willing to participate in IPOs for companies with a promising outlook, even if their governance structure is less conventional.

Third, the availability of capital in the public markets reflects the state of the debt and private capital markets. It has become a cliché to cite the amount of "dry powder" held by private equity, debt and other alternative fund managers, but the figures remain astonishing. Financial data provider Preqin noted in a report issued at the end of November 2020 that aggregate assets under management were forecast to be slightly lower at the end of 2020 than 2019 (down to $10.7 trillion from $10.8 trillion) but predicted that the figure would reach $17.2 trillion in 2025. That capital will need to find a home.

Fourth, our overall optimism is not dampened by the fact that there are likely to be many restructurings in 2021. The U.K. saw high-profile retailers, including Arcadia, Debenhams and Peacocks, enter formal insolvency proceedings during 2020. New failures will take a toll on employees and suppliers, but not all the troubled businesses will cease to exist. Some will be sold to new owners who hope to turn them around, and others will be able to raise new capital to restructure and survive.

Finally, with COVID-19 vaccinations underway, it seems reasonable to believe that, by the middle of 2021, prevention will be well advanced. If that proves right, the recovery can begin creating new opportunities for buyers, sellers and investors.

Although the unpredictability of 2020 shows how challenging predictions can be, 2021 seems likely to be a stronger year for U.K. M&A and IPOs.

UK Follows Global Trend To Enhance National Security Protections

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BREXIT

One of the biggest M&A developments over recent years has been a significant enhancing of foreign direct investment (FDI) and national security protections by G-8 members and others.

The U.S. regulatory body CFIUS (Committee on Foreign Investment in the United States) is regarded by many nations as setting the standard on how to regulate FDI. The expansion of CFIUS' powers following a new U.S. law in 2018 (the Foreign Investment Risk Review Modernization Act, or FIRRMA) has had a significant impact on cross-border M&A activity. As a result, increased focus on enhancing powers to screen and restrict M&A that raise national security concerns has since been seen in multiple jurisdictions, including:

- the European Union, with a new screening mechanism for FDI that became fully operational in October 2020;
- Germany, with a new FDI act that also took effect in October;
- Australia, with a proposed new law announced in June 2020; and
- the U.K., with a new law going through Parliament that is expected to be passed this year and would have retroactive effect from November 12, 2020.

These new regimes share some common themes, including a significant broadening of scope and a lowering, or outright removal, of monetary thresholds for review and intervention. As regulation of FDI has increased, cross-border M&A has, as a percentage of global M&A, conversely decreased. In 2019, only 30% of global M&A by value was cross-border in nature, according to Refinitiv data, with domestic M&A dominating. This was the lowest level of cross-border M&A in over a decade. If cross-border M&A is to recover, investors will have to learn to successfully navigate the new FDI terrain.

New UK Regime

The U.K.'s new regime establishes its version of CFIUS, called the Office for Investment (OFI). Previously, U.K. national security review had been carried out under the auspices of the national merger control review process, under the direction of government input. The creation of a dedicated unit is expected to lead to a significant change in approach. To put this into perspective, over almost the past two decades, there have been only 12 national security interventions in respect of U.K. M&A deals — although a third of these have occurred in the last couple of years. Going forward, according to the U.K. government, its newly formed OFI is expected to review up to 1,800 deals a year. The increased number of reviews and the significant broadening of the regime's scope (including the loosest possible U.K. nexus — where an international business servicing a single U.K.-based customer could be caught) will surely lead to a rise in interventions.

The new law also identifies sectors that require mandatory clearance. Consultation has recently taken place with industries to ascertain whether the current list of 17 sectors is appropriate — and the market is awaiting the outcome of that consultation. These sectors currently include advanced robotics and materials, artificial intelligence, communications, defense (including dual-use military), data infrastructure, energy, quantum technologies, space and transport. Many commentators have noted that the breadth of businesses intended to be covered, without a number of the typical safe harbors, is greater in scope than any other FDI regime of a major economy, including the U.S.

In addition, a side effect of this new regime is that parties to deals that fall outside the mandatory clearance regime and have only a tangential U.K. national security risk element might feel the need to nonetheless obtain clearance, if only to err on the side of caution. This is because the relevant secretary of state has broad powers to retrospectively unwind deals that he/she believes required, but didn't obtain, clearance. As such, the number of clearances sought — whether under the broad mandatory regime or on a voluntary basis — is expected to be significant. Obtaining clearance could be a lengthy process. The formal timeline can be up to four or five months, although the law allows the regulator to take even longer to make a decision.

Chinese investment has been a primary impetus for the changes in the U.K., as it has been in many other nations. Two of the four most recent M&A deals that have triggered intervention over the last couple of years under the previous regime involved Chinese-owned buyers, while the other two involved well-known U.S.- and Canada-based financial sponsors. A salutary warning that even though the focus of any new law may be narrowly identified, its ultimate application is likely to be broader.

Over the last couple of decades, one of the G-8 countries with the broadest FDI regimes has been France. Fifteen years later, the M&A world still remembers "strategic yogurt," which became a phrase to describe the mobilization of the French establishment to repel a rumored bid by Pepsi for Danone (in the words of its then-prime minister), "[to] defend the interests of France." With a number of new FDI regimes in G-8 countries and beyond, it remains to be seen whether we will see similar creative use of fresh legislative powers to repel unwelcome M&A, even when the potential threat to national security appears slight.

The Year of the SPAC

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Transactions by special purpose acquisition companies, or SPACs, exploded in 2020, resulting in a 320% increase in the number of SPAC initial public offerings (IPOs) compared to 2019. SPACs have been around for 15 years and now are established as a legitimate alternative to a traditional merger or IPO. This is due in part to an evolution of the SPAC vehicle, which now offers enhanced investor protections and positions sophisticated managers as "sponsor teams" that guide the company through both the SPAC IPO and the de-SPAC process, as further described below. SPAC prevalence is set to continue through 2021, with a significant number of both SPAC and de-SPAC transactions already in the pipeline.

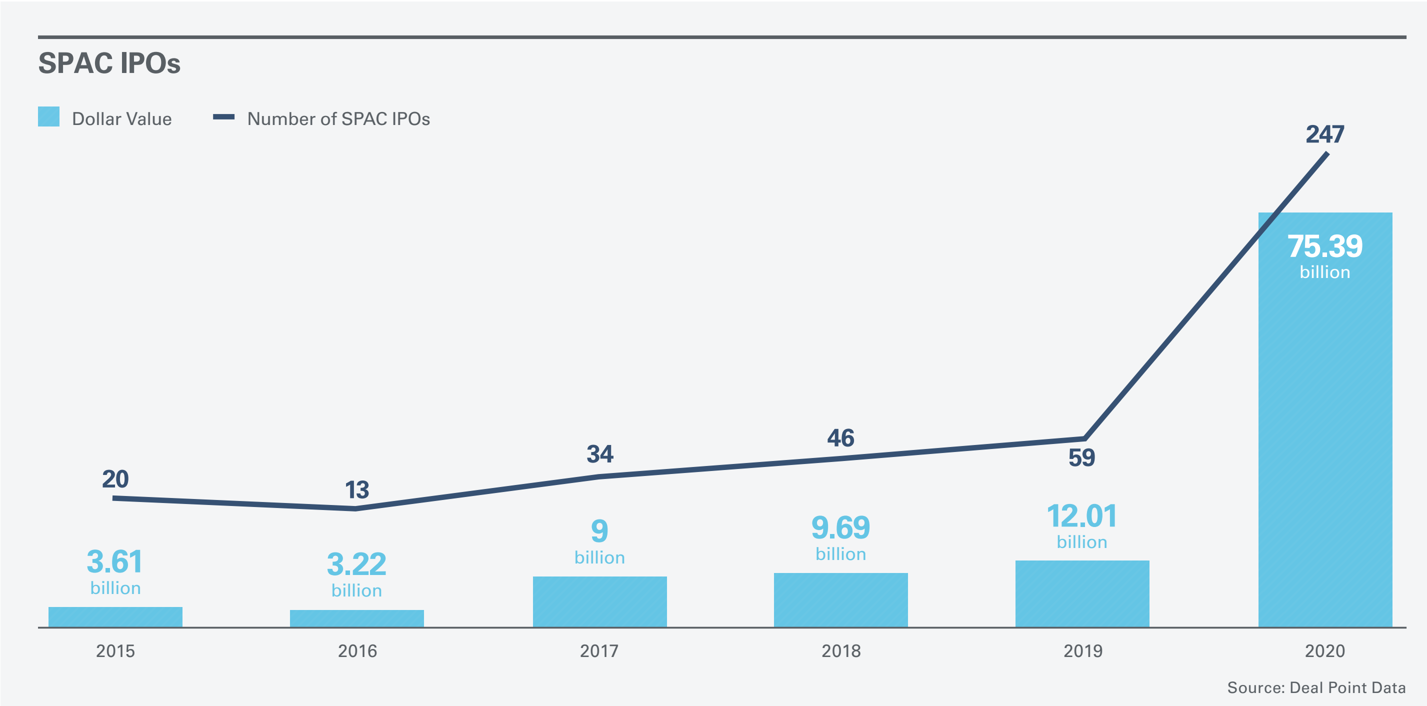
A SPAC is a public, NYSE- or Nasdaq-listed acquisition vehicle through which a sponsor team raises a pool of cash in an IPO and places that cash in a trust, to be used solely to acquire an operating target company. The SPAC is required by its charter to complete that initial business combination — or "de-SPAC" transaction — typically within 24 months, or liquidate and return the gross proceeds raised in the IPO to the public shareholders.

The popularity of SPACs can be attributed to various factors, including highly regarded sponsor teams, their unique investment structure, a better understanding by the market of the SPAC structure, the well-established complementary private investment in the public equity (PIPE) financing market, and the potential attractiveness for target companies of the subsequent acquisition as compared to a traditional IPO or M&A transaction. SPAC activity has significantly accelerated as investors seek attractive opportunities and as companies seek to partner with these best-in-class sponsor teams and exert more control over valuation and share price, including to mitigate some of the market volatility risks associated with a traditional IPO.

According to the research firm Deal Point Data, a record 247 SPAC IPOs were completed in 2020, raising total gross proceeds of approximately $75 billion, or 53% of the total number of offers and 48% of the overall IPO market by value. At the other end of the SPAC life cycle, a record $56 billion of de-SPAC transactions were announced in 2020. These figures represent a massive 320% increase in the number of SPAC IPOs, nearly a 525% increase in gross IPO proceeds and a 23% increase in the number of de-SPAC transactions, as compared to 2019, which itself was a banner year for SPACs. In 2019, there were 59 SPAC IPOs, raising approximately $12 billion of gross SPAC IPO proceeds. As shown on the next page, the 2020 volume eclipsed the prior five years combined.

Best-in-Class Sponsor Team

The SPAC is in essence its sponsor team — its founders, management and directors — and markets itself based on that team and what it can bring to a potential target. Today's SPACs are backed by accomplished teams that have extensive proprietary deal sourcing networks, experience as M&A dealmakers and demonstrated track records of success in value creation. Many SPAC sponsors in the market today are, or expect to be, serial SPAC sponsors. The importance of partnering with a quality sponsor team has been illustrated by recent Securities and Exchange Commission (SEC) comments requiring SPACs to disclose if members of their management



teams have previously been involved in a SPAC that performed poorly. From the target's perspective, choosing the right SPAC partner is critical, as picking a poorly perceived or inexperienced sponsor team could result in failure of the SPAC.

Unique Investment Structure

The SPAC investment structure is unique in that it allows public shareholders to invest alongside the sponsor team, but with downside protection. In its IPO, a SPAC typically offers units, consisting of a share of common stock and a fraction of a warrant, at $10 per share. A shareholder that prefers to exit prior to the initial business combination can sell its units in the market or choose to have its shares redeemed for its pro rata portion of cash from the IPO that is being held in the trust. This mitigates the risk to the investor of the sponsor team selecting a poor acquisition target. A shareholder that prefers to remain an investor after the initial business combination can enjoy the potential upside of continuing to hold the shares and warrants. For investors (including nontraditional SPAC investors) looking for a cash management or investment alternative, a SPAC can be an attractive option because of downside protection and the potential for significant upside, and the ability to leverage their investment.

Transparency and Understanding of Sponsor Promote Structures

The structure of the sponsor promote has received increasing attention, including by the SEC Division of Corporation Finance. In late December 2020, the SEC issued guidelines related to disclosures in SPAC IPOs and de-SPAC transactions, specifically with respect to conflicts of interest and the nature of the sponsor team's economic interests in the SPAC. (See our December 29, 2020, client alert, "SEC Staff Issues CF Disclosure Guidance on Conflicts of Interest and Special Purpose Acquisition Companies.") Generally speaking, at the time of the SPAC IPO, the sponsor receives shares (known as "founder shares" or the "promote") for $25,000 that are equivalent to 20% of the SPAC's post-IPO common share capital. The dilutive impact of these shares has contributed, in part, to the historical view that de-SPAC transactions can be more expensive from the seller's perspective than a traditional IPO. In response, some sponsors have used alternative promote structures to align incentives and distinguish themselves, with the goal of making their SPACs more attractive to IPO investors and potential target companies. In its simplest form, they achieve this by subjecting a portion of the founder shares to an "earn-out" construct, with these shares vesting only if certain post-closing trading price targets are achieved. In a more extreme example, one SPAC chose to forgo founder shares altogether. Regardless of the approach they choose, SPACs should be transparent in order to promote understanding and confidence in their structure, including among nontraditional SPAC investors.

Complementary PIPE Financings

As SPACs undertake increasingly larger de-SPAC transactions, the importance of complementary PIPE financings, and their size, has increased. By way of illustration, in 2020, the largest-ever de-SPAC PIPE transaction of $2.6 billion was announced, which was twice the size of the prior record PIPE raise announced in late 2019. In addition, it has become more common for the amount of proceeds raised in the PIPE to exceed that raised in the SPAC IPO. The well-established PIPE financing market provides numerous benefits. These include allowing SPACs to raise additional cash proceeds for the initial business combination, showing that key investors support the initial business combination, backstopping minimum cash conditions required to consummate the initial business combination (given the potential for uncertain levels of redemptions), providing upfront liquidity to the target's shareholders, and optimizing the cash and capital structure of the target as a newly public company. A particular advantage of a de-SPAC PIPE financing is that, unlike the proceeds raised in the SPAC IPO, the PIPE proceeds may be raised without the parallel sponsor promote. As a result, a smaller IPO, combined with a larger de-SPAC PIPE, can be more attractive to a potential target and public shareholders than a larger IPO with a smaller or no de-SPAC PIPE.

Alternative to Traditional IPO or M&A Transaction

SPACs have clearly established themselves as legitimate and, in many cases, preferred alternatives to a traditional IPO or M&A transaction for target companies seeking liquidity. For sponsors or investors considering an exit for a portfolio company, founders or investors in a pre-IPO company, or a strategic seeking to sell a business, a de-SPAC transaction is now routinely considered in addition to, or as a dual track alongside, a traditional IPO, strategic acquisition or other extraordinary transaction. While both a de-SPAC transaction and a traditional IPO result in a public company, the former can bring unique advantages.

A de-SPAC transaction can provide for price discovery between the SPAC target and SPAC sponsor, which can help drive higher and more certain target valuations. Compared to a traditional IPO, where valuations are derived from roadshow meetings with potential investors, investment bank guidance, initial financing rounds and comparable company offerings, de-SPAC negotiations provide an opportunity to determine, negotiate and lock in the value of the target at the beginning of the process (at signing) without being subject to pricing fluctuations and similar market risk at the very end of the process (at the actual public offering). Further, in a de-SPAC transaction, the parties are able to leverage mechanics more common to an M&A transaction, such as earn-outs, to resolve differences in price, which they would not be able to effectively implement in a traditional IPO. The flexibility to negotiate within the confines of an acquisition agreement provides additional areas of compromise to ensure that all parties can maximize value and get comfortable with a partner with whom they will be working closely for an extensive period of time after the closing.

A de-SPAC transaction also has the potential to move more efficiently than a traditional IPO process if the target is well prepared to present itself as a public company. The SPAC target must be ready with all of its required disclosures, including audited financial statements, similar to (and in some cases more extensive than) those that would be required in a traditional IPO. The target also will need best practices in place to comply with the rules and regulations governing public companies, including internal controls, public company stock exchange rules and governance requirements. Another consideration as it relates to public readiness, and different from a traditional IPO, is the necessity for the target company, under applicable law and customary practice, to publicly disclose projections in connection with the de-SPAC transaction. In a de-SPAC transaction, unlike in a traditional IPO, targets must be prepared for heightened scrutiny relating to these publicly disclosed projections and the target company's ability to achieve them in the future. All of this preparation requires cost and infrastructure investments at an early stage but can provide a target with maximum flexibility and potentially make it more attractive to a SPAC buyer.

A target company aiming for a potential de-SPAC transaction should engage early with both its experienced counsel and accountants to navigate these requirements.

European Debt and Equity Markets Resilient in Face of Turbulent Year

Contributing Partner

James A. McDonald / London

The European debt and equity markets shrugged off the impact of a nearly total shutdown due to COVID-19 at the end of the first quarter of 2020 to rebound with strong performances in the second half of the year. As activity resumed in the late spring, a number of key trends emerged, involving covenant flexibility in high-yield bonds as well as resilient equity markets in the face of both COVID-19 and the impact of pending Brexit regulation.

High-Yield Debt: The strong start to 2020 for the European high-yield market, in which bonds regained their market share from the loan market, came to an abrupt halt in March 2020, when governments imposed restrictions due to the COVID-19 pandemic. Markets began returning to life in May and June, leading to a very strong year for European high-yield issuance. An increase in default rates in 2020 reflects at least in part the impact of COVID-19 and the measures taken in response to the outbreak, but this increase did not dampen market enthusiasm for high-yield issuance. Strong volumes in the second half of 2020 were due in part to central bank bond repurchase activities intended to mitigate the impact of the pandemic and the search by investors for yield in a low-interest-rate environment. For issuers, low interest rates presented an opportunity to refinance bonds and loans, and increase liquidity.

Investment-Grade Bonds: European investment-grade bond issuance was strong and there was an increase in 2020 compared to 2019, including significant issuance in the second quarter driven by low interest rates and COVID-19 uncertainty, which led many companies to seek to raise additional liquidity to be prepared for contingencies.

Equity Issuance: Equity markets also showed strength in response to the pandemic and the unpredictability it brought, with many listed companies accessing them for liquidity. IPOs in Europe rebounded in the second half of 2020 after that market was effectively closed in the first half of the year in response to COVID-19.

Outlined below are a number of key trends from 2020.

European High-Yield Markets: Flexibility in Covenants

2020 saw a continuation of the trend of evolving high-yield covenants in Europe. These included increasingly flexible "baskets" and other exceptions for additional debt and dividends as well as other transactions traditionally restricted by high-yield bonds, such as asset sales.

There were instances in which investors called for changes in covenants after the deal was launched, and in some cases issuers responded with "tighter" covenants on terms that investors considered too flexible, for example flexibility to incur debt or make restricted payments. However, instances of investor pushback on deal terms remained the exception, and for the most part the markets showed strong demand for new bond issues, giving issuers flexibility in terms of the covenant packages they offered.

The trend was not all in the issuers' favor. A few new bond issues included increased investor protection by limiting the ability of issuers to move assets, particularly intellectual property, to unrestricted subsidiaries that were not subject to indenture covenant restrictions.

European IPOs Show Strength in Unusual Market Circumstances

The European IPO market showed strength in the face of uncertainty stemming from both COVID-19 and Brexit. There were 191 IPOs in Europe in 2020 resulting in proceeds of $26.54 billion, compared to 127 IPOs for proceeds of $23.44 billion in 2019, according to Bloomberg.

When the IPO market returned in the second half of 2020, companies and advisers reacted to the practical limitations on the IPO process with virtual drafting meetings and roadshows. The virtual IPO marketing process even provided some improvements on the traditional one; reduced travel meant increasing the number of potential meetings and decreasing the time associated with traditional IPO roadshows.

While the U.S. IPO market was significantly influenced by the remarkable year for IPOs of SPACs, this trend was not seen to the same degree in Europe; SPAC IPOs represented approximately 53% of IPO volume in the U.S. in 2020, whereas SPACs represented only a small percentage of IPOs in Europe. However, the U.S. SPAC trend did impact the European IPO market, with some European businesses opting for mergers with U.S. SPACs instead of a traditional IPO. (See "The Year of the SPAC.")

Brexit Impact

The United Kingdom left the European Union on January 31, 2020, but with many of the rules governing the relationship between the U.K. and the EU left to further regulation to be put in place by the end of 2020. The two parties reached an agreement on December 24, 2020, and the regulations became effective on January 1, 2021. In 2020, the capital markets accepted the uncertainty, with sterling-denominated corporate bond issuance — including high-yield and investment-grade — increasing in 2020 compared to 2019. IPOs on the London Stock Exchange (LSE) were down in 2020 as compared to 2019, which itself saw a decrease from the previous year. In all, 17 IPOs listed on the LSE in 2020, according to Barclays.

Outlook

With the European high-yield market showing no signs of slowing down, market conditions bode well for a strong start to 2021. An increase in M&A in Europe will help to continue this trend, with issuance in 2020 dominated by companies looking to refinance or raise capital for general corporate purposes. (See "2021 Forecast for UK M&A and IPOs: Delayed Gratification?")

IPO markets also show no signs of slowing down, and it remains to be seen whether the U.S. trend in SPAC IPOs will transfer to Europe, with early signs showing the European markets starting to embrace the SPAC trend.

Hong Kong's Exchange Improves Its Allure for Chinese Issuers

Contributing Partners

Christopher W. Betts / Hong Kong

Paloma Wang / Hong Kong

Despite the impact of COVID-19 and other recent developments in Hong Kong, the city's role as a center for China-based companies to raise capital became even more important in 2020. The momentum of several trends that began developing a year ago has, if anything, played out in a far more pronounced manner than we anticipated.

Two significant trends emerged in late 2019:

- new secondary listings on the Hong Kong Stock Exchange (HKEX) of large, primarily tech-related companies that were already listed in the United States; and
- the expansion of HKEX's position as a credible market for biotech and health care companies to raise capital.

Both trends stem from new HKEX rules adopted in 2018, but these changes really did not begin to have an impact until 2020.

At the beginning of 2020, Alibaba was the only U.S.-listed company that had completed a secondary listing under the new rules. By the end of 2020, there were 10 so-called "homecoming IPOs" on HKEX, with concurrent public offerings in Hong Kong. Among these were the listings of JD.com and NetEase, two of the three largest public offerings in Hong Kong in the first half of 2020. For the full year, approximately $17 billion was raised through such offerings.

This trend has been driven in part by regulatory developments in the U.S. In December 2020, the Holding Foreign Companies Accountable Act was signed into law by President Trump, prohibiting foreign companies from listing on U.S. exchanges if they retain a foreign accounting firm that cannot be inspected by the Public Company Accounting Oversight Board (PCAOB) for three consecutive years, beginning in 2021. Because inspection of audit firms' working papers in China is subject to regulations in China, there is hope that the Securities and Exchange Commission and PCAOB will reach an understanding within the next three years with the relevant Chinese authorities on PCAOB inspection of the audit working papers in China. However, the new law comes against the backdrop of a challenging period in the U.S.-China relationship, and Chinese regulators' concerns about national security threats are ongoing, creating headwinds for any efforts to reach an understanding. (See "US-China Trade and Enforcement Issues: What's Next?") A critical mass of U.S.-listed Chinese tech companies chose to avail themselves of a secondary listing in Hong Kong this year as a contingency plan and to create an additional platform for raising capital closer to many of their stakeholders, making it more likely that additional companies will follow.

The second trend, even more pronounced, is the increase in pre-revenue biotech companies listing on HKEX. The 28 biotech companies now listed on HKEX had a collective market capitalization of almost $90 billion at the end of 2020, and an ecosystem of other stakeholders is growing around them, including investors, research analysts and senior executives. Unlike some prior HKEX initiatives that were met with a more muted response (such as the effort to attract mining companies to HKEX), the exchange's biotech initiative has now gained sufficient critical mass. Given the rapid growth in health care-related spending in China and the significant room for further growth, the positive reception to HKEX's biotech initiative is clearly underpinned by a more solid macroeconomic story.

Adding to the momentum in this sector, many of HKEX's biotech companies have seen significant share price appreciation and have been able to conduct sizeable follow-on offerings. Several have now also gone on to complete domestic Chinese offerings of A shares. (Chinese regulations prohibit domestically traded A shares from being exchangeable for Hong Kong or other foreign-listed securities.)

To make HKEX even more attractive to biotech companies, in November 2020, HKEX announced an agreement with the Shanghai and Shenzhen stock exchanges (SSE and SZSE, respectively) that shares of pre-revenue biotech companies are eligible to be traded through the Stock Connect program. The program allows investors located in Shanghai and Shenzhen to trade directly in certain HKEX-listed securities (southbound trading) while also permitting Hong Kong-based investors to trade directly in certain SSE- and SZSE-listed securities (northbound trading). Specifically, pre-revenue biotech companies listed under Chapter 18A of the Hong Kong Listing Rules that are eligible constituent stocks of the Hang Seng Composite Index, or have corresponding A shares listed on SSE or SZSE, will be included in southbound trading under the existing Stock Connect arrangements. These changes are expected to take effect in early 2021.

In the meantime, HKEX has been soliciting feedback on various amendments to its listing rules, some of which are arguably long overdue. The proposals include amendments aimed at:

- facilitating a "paperless" initial public offering (IPO) process, doing away with the need to print tens of thousands of physical prospectuses and application forms and making them available at retail bank branches throughout Hong Kong;
- shortening the IPO settlement process, most significantly by reducing the exceedingly long period between pricing and closing for Hong Kong IPOs from five business days to one;
- strengthening the disciplinary powers of HKEX, for example by providing HKEX with the ability to delist companies that retain directors or officers who have overseen flagrant breaches of HKEX listing rules; and
- continuing to raise the standards for initial listings (including by raising the minimum profit requirements for listings on the Main Board of HKEX) and closing perceived loopholes that HKEX fears may lead to listings of companies that are or may become "listed shells."

For the last decade, HKEX has been the No. 1 market globally for IPOs by funds raised. It has benefited from its market position as the only licensed exchange in Hong Kong and the only market within China where Chinese companies can raise capital freely exchangeable into foreign currency. HKEX also has as an advantage its proximity to mainland China and the perception that it is the "home" market of choice for Chinese issuers. Against a shifting geopolitical backdrop that may continue to favor it as a listing venue, HKEX is seeking to strengthen its position with China-based issuers. However, whether HKEX can become an attractive venue for issuers beyond those with immediate and deep links to China remains to be seen.

US Corporate Governance: The Ascension of ESG

Contributing Partner

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The change in administration is expected to bring a governmental and regulatory climate that is vastly more hospitable to calls to facilitate the incorporation of environmental, social and governance (ESG) factors into investors' decision-making. This may take the form of a Securities and Exchange Commission (SEC) that is much more receptive to investor exhortations to mandate what they believe to be more meaningful and comparable company disclosures across a spectrum of ESG topics. Although the potential impact of this expected change in the regulatory climate should not be discounted, the reality is that the events of 2020 — chiefly, the COVID-19 pandemic and the increased focus on systemic racism following the murder of George Floyd — have accelerated and cemented the rise of ESG.

In this context, investors are placing more scrutiny than ever on how companies articulate their purpose and whether company interactions with their stakeholders — customers, employees, suppliers, investors and communities — drive long-term profitability, reduce risk and enhance business resiliency. In turn, boards of directors and board committees have been devoting ever-increasing levels of attention to oversight of ESG matters and likely will need to continue to do so.

Board, Management and Workforce Diversity

One example of the ascension of ESG relates to diversity, particularly racial and ethnic diversity, a topic implicating both the "S" and the "G." From a governance perspective, investors and others have embraced the view that diverse perspectives lead to better decision-making and, in turn, can reduce risk and improve company resiliency. From a social perspective, increasing board, management and workforce diversity presents an avenue to address systemic racism as well as racial wealth and income gaps exacerbated by the lack of diversity at certain levels within organizations.

Although board, management and workforce diversity are by no means new topics of interest for investors, the speed and intensity of enhanced investor focus in these areas over the second half of 2020 may be unparalleled. BlackRock, State Street and Vanguard — for many public companies, three of their largest shareholders — have each called for boards of directors to articulate their approach to board diversity as well as to oversight of diversity matters more generally. In addition, all three have indicated that they may vote against directors on boards they view as not having made sufficient progress in addressing diversity. Additionally, Legal & General Investment Management has said it will begin voting against nominating committee chairs at S&P 500 companies in 2022 if the board lacks any racially or ethnically diverse directors. Also, a number of state and local pension funds and other socially responsible investors have been engaged in letter-writing campaigns calling on companies to increase disclosure of director diversity and alluding to the possibility of negative votes at companies lacking board diversity.

The focus on board diversity is gaining momentum in other concrete ways. Proxy advisory firms Institutional Shareholder

Services (ISS) and Glass Lewis have updated their policies and, for 2021, will flag boards lacking racial or ethnic diversity. In the case of Glass Lewis, the firm also will note a concern regarding boards with only one woman director. Negative voting recommendations from ISS and Glass Lewis relating to these items will start in 2022. In September 2020, California adopted a requirement that boards of public companies headquartered in California have at least one director from an underrepresented community by the end of 2021 and, depending on board size, at least two or three such directors by the end of 2022. Nasdaq has proposed listing standards that would require increased disclosure on director diversity and, subject to a phase-in period and a "comply or explain" approach, that Nasdaq-listed companies have at least one woman director and one director who is either racially or ethnically diverse or is a member of the LGBTQ+ community. The cumulative effect of investor and other efforts to increase board diversity resulted in a number of companies adding diverse directors in the last few months of 2020 and is likely to drive significant board refreshment efforts during 2021 and beyond.

This investor focus on diversity does not stop at the boardroom door. The New York City comptroller, among others, has led a campaign to increase company disclosure of EEO-1 report data. Provided by companies to the Equal Employment Opportunity Commission on an annual basis, this data reports the gender and racial/ethnic breakdown of a company's U.S. workforce in 10 specified job categories. According to a press release issued by Comptroller Scott M. Stringer, the initial letters to 67 S&P 100 companies resulted in 40 companies agreeing to provide this disclosure, and the comptroller has submitted shareholder proposals on this topic to 24 companies that did not respond to the letter. A number of other investors, including BlackRock, State Street and Vanguard, also have called for enhanced workforce diversity disclosure, including disclosure of EEO-1 report data. Recently, State Street announced that, in 2022, it will vote against compensation committee chairs at S&P 500 companies that do not disclose their EEO-1 report data. In addition, Comptroller Stringer has submitted shareholder proposals to four S&P 500 companies that appear to lack racial or ethnic diversity in their executive ranks, calling on those companies to adopt a policy that when senior executives are recruited from outside the company the initial list of candidates will include qualified female and racially/ethnically diverse candidates.

Investor concern regarding company approaches to diversity is not limited to board and workforce matters. Recently, some companies have received shareholder proposals seeking board reviews or "audits" to assess the racial impact of the company's products, services or policies, or to assess the company's impact on communities of color. Although it remains to be seen whether companies will be successful in their efforts to exclude these proposals from their proxy materials and what level of shareholder support these proposals will garner if voted on, their submission represents an investor focus — through a lens of racial equity — on the companies' relationships with customers, suppliers, communities and other stakeholders.

Climate Change and Sustainability

Another example of the ascension of ESG relates to investor policies on climate change and sustainability matters — the "E" in ESG. Early in 2020, BlackRock's annual letter to CEOs stated that "climate risk is investment risk." As evidenced by seven shareholder proposals that received majority support in 2020, compared to none in 2019, climate change and sustainability issues have been areas of ongoing and increasing investor focus. For some, the economic upheaval resulting from the coronavirus pandemic is a harbinger of the type of economic upheaval that may be caused by climate change. In recent months, the Board of Governors of the Federal Reserve System has recognized the risks climate change poses to the U.S. financial system, and an advisory committee subcommittee report to the Commodity Futures Trading Commission stated that "[c]limate change poses a major risk to the stability of the U.S. financial system and to its ability to sustain the American economy."

In announcing its expectations for 2021, BlackRock stated that it is expanding the group of companies for which it focuses on climate change from 440 to more than 1,000, calling on these companies to "disclose a business plan aligned with the goal of limiting global warming to well below 2 degrees Celsius, consistent with achieving net zero global GHG emissions by 2050." In addition, BlackRock will evaluate whether companies' public statements on policy issues that are material to their strategies align with their corporate political activities. Moreover, BlackRock is changing its approach to voting on shareholder proposals relating to sustainability matters. Under the new policy, for 2021, BlackRock may support shareholder proposals on relevant sustainability issues where it agrees with the intent of the proposal, without waiting to assess the effectiveness of BlackRock's engagement with management on moving the issue forward, or where it believes management is making progress but that voting for the proposal may accelerate progress.

In June 2020, Vanguard published a note describing its expectations for companies and boards with respect to climate risk governance. Vanguard indicated that it expects companies to be aware of climate risks and opportunities, and that boards should effectively oversee their companies' approach in this area and be transparent about their decision-making processes. Vanguard also cited favorably the framework created by the Financial Stability Board's Task Force on Climate-related Financial Disclosures for disclosing climate change-related strategy, risk management, governance, metrics and targets. In addition, Vanguard notes that where climate issues are material to a company, it expects an effective board to include directors with relevant climate change competency and experience, and related experiences such as change management and pivoting businesses to take advantage of new technologies.

COVID-19

State Street has expressed its belief that "the COVID-19 crisis accelerates the need for transformative change to address climate change" and that it will continue to "encourage companies to disclose how they are addressing both climate risks and opportunities through engagement and voting on shareholder proposals." In addition, State Street recently became a member of Climate Action 100+, an investor engagement initiative on climate change, and announced that its climate change focus will be on companies it believes are "especially vulnerable to the transition risks of climate change," as well as "companies in other sectors that, while not as carbon intensive, also face risks such as the physical impacts of climate change."

To date, there have been a few activist investor situations in which the investment hypothesis involved the potential upside of more climate-friendly changes in operations. Perhaps the largest test of this activist strategy will take place in 2021 as a major U.S. oil company faces the prospect of a proxy fight to refresh the board of directors with candidates the activist views as more capable of implementing the strategic changes necessary to create value in a world adapting to climate change.

In light of these updates, we expect a rising number of climate change- and sustainability-related shareholder proposals to receive majority support at 2021 annual meetings, as well as increasing levels of investor-company engagement on these topics. (See "Climate Change Should Drive Energy and Environmental Policy.")

Senate Working Group

In October 2020, Democratic Sens. Elizabeth Warren, Tom Carper, Tammy Baldwin and Mark Warner announced their formation of a working group to develop legislative proposals relating to corporate governance. In 2018, Sen. Warren introduced the Accountable Capitalism Act, which would require companies with more than $1 billion in revenue to obtain a federal charter stating the company's "purpose of creating a general public benefit," defined as "a material positive impact on society resulting from the business and operations" of the company. Whether that bill or similar legislation is introduced in the Democratic-controlled Senate remains to be seen. Although investor-led efforts, such as those described above, will continue to drive the ESG agenda, it is likely that this working group will attempt to move an ESG and corporate stakeholder-centric agenda forward via legislation.

Board Oversight

The key takeaway for boards of directors is that investors expect them to exercise oversight of their companies' approach to material ESG issues and consider their companies' impact on stakeholders beyond shareholders. As reflected in a recent Glass Lewis voting policy update, beginning in 2021, for companies in the S&P 500 index, Glass Lewis will note as a concern the absence of clear disclosure of board-level oversight for environmental and social issues. Then, beginning in 2022, for S&P 500 companies, Glass Lewis will escalate this concern by generally recommending against governance committee chairs for failure to provide disclosure of board-level oversight of these issues. BlackRock, State Street and Vanguard have each expressed that they expect to continue to engage with companies and directors on a variety of ESG topics, seeking to understand the board's approach to overseeing matters such as the company's approach to diversity, climate change and other ESG topics. For companies that have not yet done so, the first step is to ascertain which ESG topics are material to their company and then assess the best approach for board oversight.

The events of 2020 and their aftermath have made it clear that ESG is not a fad that will recede, even during a crisis. If anything, 2020 made ESG's importance clear to investors and firmly established ESG as being a more important engagement and voting topic going forward.

Uptick in Restructurings May Outlast COVID-19 Pandemic

The COVID-19 pandemic has caused massive disruption across the globe, resulting in a significant uptick in U.S. restructuring activity. According to AACER, a database of U.S. bankruptcy statistics, an estimated 7,128 business bankruptcies were filed in 2020, representing a 29% increase over the same period last year. Although Chapter 11 filings increased in 2020, many experts believe we have yet to see the full extent of the surge in filings that will occur in the aftermath of the COVID-19 crisis.

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COVID-19

Business bankruptcies peaked at 13,683 in 2009 at the height of the financial crisis and steadily declined in the years thereafter before leveling off to approximately 6,000 filings per year from 2014 to 2019. Although Chapter 11 filings rose in 2020, we did not see the same volume of filings as occurred in 2009. This is in large part due to the unprecedented support provided by the federal government, which allowed many companies that otherwise would have had to file for bankruptcy to weather the economic effects of the pandemic. Looking ahead, while COVID-19 vaccines are now being distributed, uncertainty remains as to when they will be widely available, whether the second stimulus package — including $284 billion in additional loans under the Paycheck Protection Program (PPP) — will be sufficient support for small businesses in the interim, whether certain consumer trends (*e.g.*, business travel) will return to pre-pandemic levels, and how quickly the economy and troubled companies can rebound. These and other factors will affect the volume of Chapter 11 filings in 2021 and beyond.

The chart on the next page depicts corporate Chapter 11 filing volume over time.

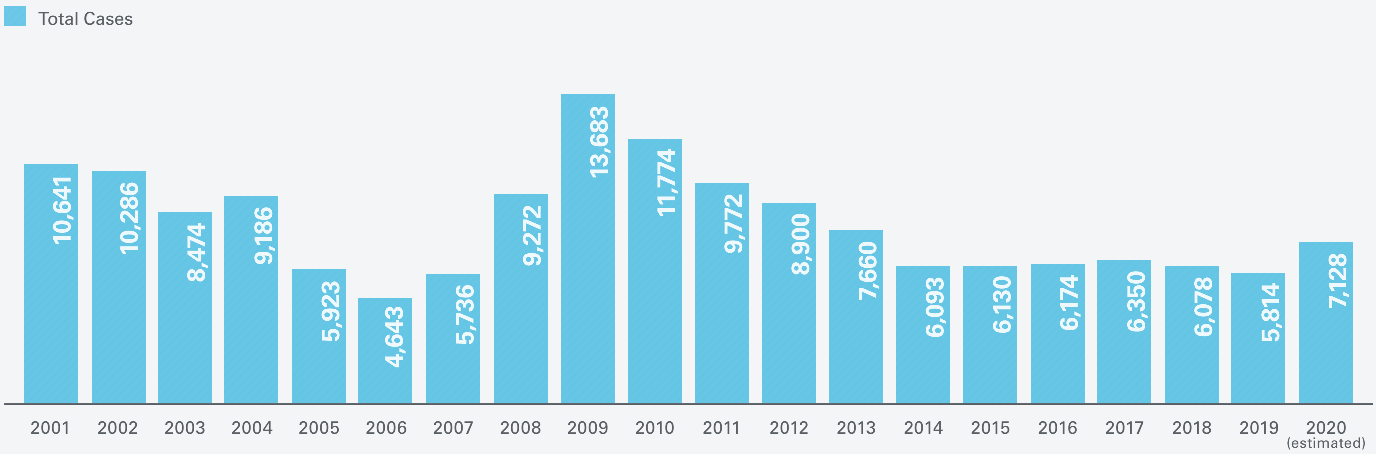
Large public company Chapter 11 filings (*i.e.*, public companies with assets greater than $310 million) follow similar trends. Fifty-eight large public companies filed for Chapter 11 in 2020, up from 25 filings in 2019 but well below the more than 90 filings of large companies in 2001 and 2009, when the dot-com crash and financial crisis, respectively, sent the number of filings higher. The chart on the next page shows the volume of large public company Chapter 11 cases over time. Although filings rose in 2020, many large troubled public companies were able to access the capital markets and/or negotiate consensual out-of-court restructurings with their creditors, which may have contributed to the lower level of filings than in 2001 and 2009.

Early in the COVID-19 pandemic, many companies sought to maximize liquidity in order to weather the storm, drawing down on their revolving credit facilities to do so. U.S. companies are estimated to have drawn down more than $175 billion from revolving credit facilities in March 2020. Some companies sought to preserve liquidity by deferring interest payments, stretching out payables, accelerating receivables and extending debt maturities. Other companies sought to take advantage of market volatility by engaging in debt-for-equity and debt-for-debt exchanges. These common liability management tactics were largely successful in extending the runway for many companies.

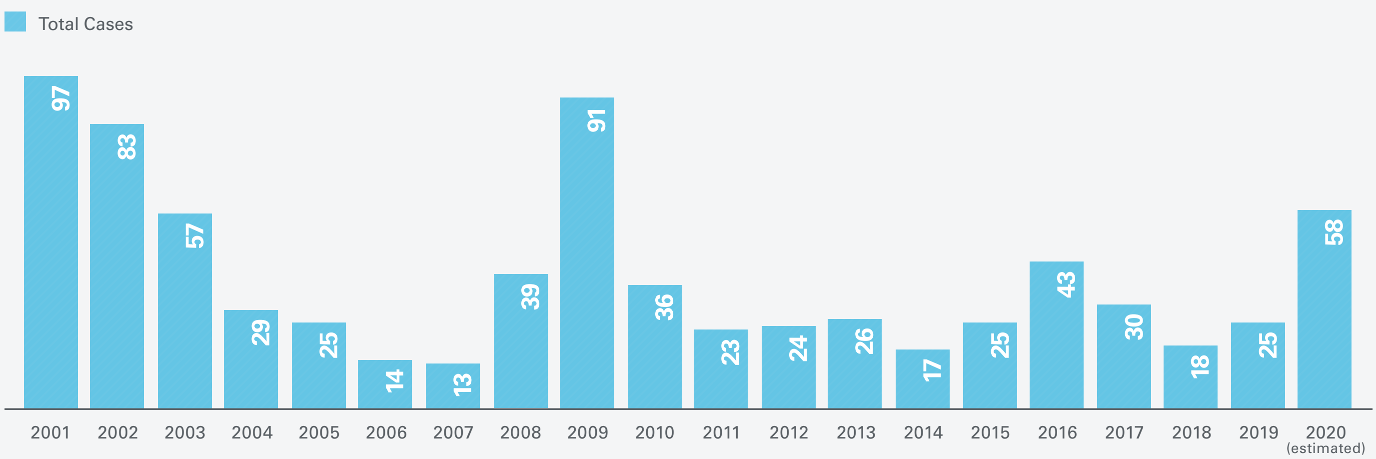
Many countries passed economic stimulus legislation in response to the economic impact of the COVID-19 pandemic. In the U.S., the first stimulus package, known as the CARES Act, provided federal funding for businesses in three broad categories:

- $350 billion to support small businesses through programs administered by the

Business Bankruptcy Filing Volume, 2001-2020



Large Public Company Bankruptcy Filing Volume, 2001-2020



Small Business Administration, including the Paycheck Protection Program;

- $45 billion of support in the form of grants and loans from Treasury to passenger air carriers and related businesses, cargo air carriers and businesses critical to maintaining national security; and
- authority for Treasury to invest more than $450 billion in lending programs to be established by the Federal Reserve.

The Federal Reserve programs include two “Main Street” programs intended to provide credit to medium-sized U.S. businesses (companies with either no more than 10,000 employees or no more than $2.5 billion in 2019 revenues). (See our client alert, updated on June 10, 2020, “Updated Guide to the Main Street Lending Program.”) The Federal Reserve also announced a corporate bond purchase program in March 2020. Through the program, the Federal Reserve is authorized to buy both newly issued debt on the primary market and debt that is already trading on the secondary market. In response to the Federal Reserve’s announcement, the capital markets opened up dramatically, allowing many companies to raise much-needed capital.

The recently enacted second stimulus package provides targeted aid to small businesses through $284 billion in additional loans under the PPP. The latest package includes stricter terms that appear intended to address one of the main criticisms of the prior legislation, which allowed a large proportion of the funds to flow to a small number of borrowers. (One percent of borrowers received a quarter of the loans under the prior PPP.) Under the new legislation, only borrowers with fewer than 300 employees that experienced at least a 25% drop in sales from a year earlier in at least one quarter will be eligible. The new legislation also reduces loans under the PPP from $10 million to $2 million and prohibits publicly traded companies from applying this time around. In addition to funding for small businesses, the package provides $15 billion in grants to support entertainment-related businesses such as live venues, movie theaters, museum operators and other cultural providers that have been particularly hard hit by the pandemic.

2021 Outlook

Although the economic stimulus package and the capital markets may have helped a substantial portion of corporate America in the short term, a number of companies have not had and will not have the same access to capital. Consumer-facing industries, including brick-and-mortar retail, restaurants, lodging, travel, cruise lines and airlines, among others, continue to feel the economic effects of stay-at-home orders and travel restrictions. Meanwhile, thousands of other companies remain exposed to significant supply chain disruptions as a result of the unprecedented nature of the COVID-19 pandemic and its profound impact on the global economy. A 2020 study by the supply chain risk management firm Interos found that more than 90% of companies expect that the disruption in the global supply chain caused by the COVID-19 pandemic will have a long-lasting impact on their businesses. Of the 450 senior decision-makers in the U.S. who took the survey, 98% said that their organization's supply chain was disrupted by the pandemic. Disruption took many forms, including supply shortages, demand reduction and price swings, posing a threat to the operational stability of many companies. Some experts predict that the true impact of the pandemic will not be clear until mid-2021 as the initial effects of the crisis ripple through the global supply chain.

The United States' record-high corporate debt levels may exacerbate the economic damage caused by COVID-19. Low interest rates and easy access to credit allowed large U.S. companies to borrow approximately $10.5 trillion of debt through August 2020, according to Bank of America Global Research, which is approximately 50% of the country's gross domestic product (GDP) — the highest ratio of corporate debt to GDP in U.S. history. This amount of debt represents a rise of 59% from its last peak in 2008, when corporate debt was at $6.6 trillion, approximately 44% of GDP. Of that total, approximately $1.2 trillion is in the form of leveraged loans and about $5 trillion will become due in the next five years. The economic impact of COVID-19, when combined with this level of debt, may serve as the catalyst for the next wave of restructuring.

Many uncertainties remain heading into 2021. Companies that anticipate facing liquidity or covenant issues or that have a significant amount of debt coming due in the next couple of years should be proactive in evaluating their liability management options to ensure that they are well-positioned to not only withstand the pandemic but also be successful in the long term.

Corporate Sponsorship of Private Funds as an Integrated Asset Finance Platform

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In recent years, investment managers sponsored by established corporate enterprises (Corporate Sponsors) and corporate sponsored funds (CSFs) have been established with increasing frequency across a range of sectors, markets and geographies, buoyed by the drive of leading institutional fund investors (Investors) to partner with market leaders and deploy significant amounts of capital into select opportunities that traditional channels may not offer.

CSFs present a range of advantages for Corporate Sponsors and Investors, including their ability to support a Corporate Sponsor's key strategic objectives and secure high-upstream investment opportunities for Investors.

Corporate Sponsored Funds

CSFs are private funds sponsored by an investment manager that is affiliated with Corporate Sponsors carrying on a core business other than investment management. At one level, CSFs reflect established capital markets norms, because many of the world's leading investment managers have, at one time or another in their development, been affiliated with diversified enterprises. What is novel about CSFs is their ability to address Investors' capital deployment and deal flow needs in harder-to-access strategies, including capital-intensive strategies such as infrastructure, credit, pharmaceuticals, energy, telecommunications and real assets through asset-level expertise and focus derived from the institutional capabilities of a Corporate Sponsor. As a result, CSFs have a unique ability to provide proprietary deal flow to private capital Investors.

CSFs benefit from the unique advantages of private capital structures in supporting and accelerating the growth and evolution of a Corporate Sponsor's business. They also harness the positives of the platforms provided by Corporate Sponsors, which are typically mature, prominent enterprises of scale with core businesses naturally suited to large-scale capital deployment. CSFs are typically managed by a dedicated subsidiary of the Corporate Sponsor (a Corporate Affiliated Manager) with the expertise to steer CSF capital surgically into favored growth strategies, business lines or divisions of a Corporate Sponsor in a manner supportive of a long-term, programmatic relationship with Investors. This opportunity for strategy segmentation through a CSF can represent a significant pathway for a Corporate Sponsor to execute particularly important elements of its overall strategy, while managing balance sheet exposure through control over the size of its capital contribution to the CSF.

Benefits for Corporate Affiliated Managers and Their Corporate Sponsors

Like other private funds, CSFs can generate attractive revenues for the Corporate Sponsor, primarily through a share of management fees and carried interest paid to the Corporate Affiliated Manager by the CSF. Additionally, with the Corporate Sponsor's participation in a portion of these management fees and carried interest, CSFs can help to monetize for the Corporate Sponsor the acumen of in-house investment teams.

CSFs also provide the Corporate Sponsor with certainty of capital for its key strategic goals on terms that compare favorably with conventional sources of equity and debt financing. CSFs avoid the unwelcome effects (and costs) of over-dependence on debt issuance and equity issuance, while retaining control of strategy and high-value strategy expansion.

CSFs also enable Corporate Sponsors to overcome balance sheet and capital constraints that may make it more difficult to achieve strategic and commercial objectives. CSFs can provide relatively stable, long-term capital that compares favorably to other capital sources, and aids in the conservation of balance sheet capital. In addition, CSFs may be structured so as to be consolidated or deconsolidated for corporate finance, debt covenant, accounting and balance sheet purposes, which helps preserve flexibility for the Corporate Sponsor to pursue key objectives.

Benefits for CSF Investors

CSFs can facilitate Investor expansion of direct investment programs over time, including through portfolio company exits by CSFs to Investors, while mitigating Investor perceptions of new sponsor risk by brand backing, performance information, technical expertise and well-developed support functions. To this end, leading enterprises are often well positioned to offer significant, prespecified portfolios of closing assets, attractive co-investment opportunities and ongoing, large-scale deal flow to Investors through CSFs.

CSFs also offer Investors governance structures that are familiar and reflective of Investors' existing relationships with other private funds, including those run by established, multistrategy managers not affiliated with Corporate Sponsors. Governance and alignment mechanisms for CSFs typically rest on best practices and negotiated terms common to many private funds, such as independent investment committee bodies, carefully defined investment guidelines and a role for the CSF's Investor advisory committee, as well as transaction-specific governance provisions and mechanisms. In this way, CSFs offer leading Investors privileged access to preferred deal flow within a Corporate Sponsor's investment, development or acquisition pipeline. Utilizing best practices in conflict management to unlock access to investment opportunities available through the Corporate Sponsor, CSFs, like other private capital structures, can serve to create and strengthen long-term relationships between Corporate Sponsors and Investors that are protected by the fund governance norms familiar to Investors.

Conclusion

As leading corporate entities seek to monetize in-house investment acumen and focus on key business lines to drive growth and market share, preservation of balance sheet capital and targeted partnering with Investors will remain critical. CSFs provide Corporate Sponsors with a unique opportunity to combine the inherent flexibility of private capital transactions with the advantages of sponsor-favorable market norms to define the future of their key business lines.

Litigation / Controversy

Despite Pandemic-Related Disruptions, Securities Class Action Filings Remain High With No Signs of Slowing

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Despite unprecedented disruptions to the court system from the COVID-19 pandemic, plaintiffs continued to bring securities class actions at elevated levels in 2020 — a sign that filings will remain high in the year ahead. Based on data from Cornerstone Research through September 30, 2020, plaintiffs were on pace to file approximately 375 federal and state securities class actions through the end of the year. Although lower than the more than 400 actions filed in each of the previous three years, this figure is still substantially higher than the 261 cases brought, on average, between 2010 and 2019.

COVID-19

The moderate slowdown in filings is likely due to the pandemic, which led to widespread court closures and fewer mergers in the first half of 2020. The drop-off in M&A activity, in particular, led to a corresponding decline in federal merger objection lawsuits — a major contributor to overall filings since 2016. At the same time, the pandemic fueled its own cluster of event-driven cases, producing an estimated 16 securities-related actions through September 30, 2020. This represents the continuation of a development we observed in 2019 in event-driven litigation filings — matters where the catalyst is the disclosure or occurrence of a significant event that negatively impacts stock performance.

The New Year May Usher in Even More Claims Against Non-US Issuers and SPACs

Securities filings against non-U.S. companies have continued to rise, with 35 such lawsuits initiated in the first half of 2020. If this pace continues, total filings for 2020 would exceed the prior record of 56, registered just one year earlier. Thus far, plaintiffs have focused substantially on Chinese firms that have delisted from U.S. exchanges (more than 60 since 2013). In the first half of 2020, 13 of the 35 suits against non-U.S. issuers fell into this category. In the Chinese issuer cases, a recurring theme has been the purported failure of these firms to disclose alleged violations of Chinese government regulations. (See "Hong Kong's Exchange Improves Its Allure for Chinese Issuers.")

We are also seeing an uptick in cases against special purpose acquisition companies. These companies, SPACs, are formed for the purpose of acquiring privately held businesses, typically through reverse mergers in which the operating entity or target survives and becomes a publicly traded issuer. According to the research firm Deal Point Data, there was an explosion of SPAC-related activity in 2020, with 247 IPOs, compared to 59 offerings in all of 2019. (See "The Year of the SPAC.") The offerings, referred to as de-SPAC transactions, have sparked a wave of securities actions in which investors claim to have been misled about facts bearing on the target's financial condition, prospects or operations. Bypassing litigation, some plaintiffs firms have also made behind-the-scenes demands, claiming that shareholders were deceived by the issuer's regulatory filings and seeking curative disclosures in exchange for a quick settlement and attorneys' fees. Given the growing importance of SPACs, we expect to see more of these cases (and demands) in 2021.

Exclusive Federal Forum Provisions and Case Law Developments Will Continue To Shape '33 Act Litigation Post-*Cyan*

State court filings with Securities Act of 1933 ('33 Act) claims are on pace to decline for the first time since the U.S. Supreme Court's 2018 decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*. Beyond the pandemic, this decline may be traceable in part to the Delaware Supreme Court's 2020 decision in *Salzberg v. Sciabacucchi* (*Blue Apron II*), which held that Delaware corporations may include provisions in their certificates of incorporation requiring '33 Act claims to be brought in federal court. This highly anticipated decision will no doubt encourage more Delaware corporations to adopt exclusive federal forum provisions (FFPs).

Whether other state courts consistently uphold the validity of FFPs remains to be seen. Thus far, two California state judges — in *Wong v. Restoration Robotics* and *In re Uber Technologies* — have enforced FFPs, albeit on grounds different from those laid out by the Delaware Supreme Court in *Blue Apron II*. (Both courts relied on principles of California — rather than Delaware — law.) If other jurisdictions follow suit, FFPs could become a potent tool for eliminating duplicative litigation by steering '33 Act claims to the federal courts, where procedures exist for consolidation. Plaintiffs, however, have raised several legal objections — among them, that by enforcing FFPs, courts are impermissibly regulating interstate commerce in violation of the U.S. Constitution's Commerce Clause. The coming year may offer greater clarity about the viability of plaintiffs' constitutional and other challenges.

In the meantime, we will monitor additional case law developments at the state court level. One threshold issue is whether plaintiffs can survive motions to dismiss. In a notable ruling from December 2020, New York's Appellate Division reversed a trial court order and dismissed '33 Act claims stemming from the initial public offering (IPO) of Ruhnn Holding Limited, a recruiter, trainer and manager of social media influencers for China's e-commerce market. The plaintiffs alleged that Ruhnn was required to disclose updated numbers on store closings from the most recent quarter at the time of the IPO. In dismissing the complaint, the appellate court relied on the U.S. Court of Appeals for the Second Circuit's decision in *Stadnick v. Vivint Solar* to conclude that the plaintiffs were viewing the store closings too "myopically." This is believed to be the first time that a New York state court has applied the Second Circuit's holistic standard for evaluating the accuracy of registration statements.

The decision represents the first post-*Cyan* ruling by a New York appellate court and highlights a key feature of its procedural rules. Unlike in the federal system, where appeals generally must wait for a final judgment or order resolving all claims against all parties, defendants in New York state courts can immediately appeal the denial of a motion to dismiss. This distinction highlights a unique risk that plaintiffs face when opting for New York state court. Because a large number of '33 Act claims are typically filed in New York, we will be looking to see if *Ruhnn* has any impact going forward on plaintiffs' willingness to litigate in the Empire State.

Shift in Supreme Court's Composition Could Impact the Future Course of Securities Litigation Jurisprudence

The coming year may also offer clues about whether the U.S. Supreme Court's evolving composition — including the recent appointment of Justice Amy Coney Barrett — will lead to a corresponding shift in its securities litigation jurisprudence. (See *Insights Special Edition: US Supreme Court Term*.)

Prior to joining the high court, Justice Barrett did not write or speak about topics related to securities litigation, either as a member of the U.S. Court of Appeals for the Seventh Circuit or as a professor at Notre Dame Law School. She did, however, join majority opinions in several securities and derivative cases, including one — *In re Allstate Corporation Securities Litigation* — that may shed light on how the Court could rule in a case before it this term, *Goldman Sachs Group Inc. v. Arkansas Teacher Retirement System* (*Arkansas Teachers*).

On appeal from the Second Circuit, *Arkansas Teachers* raises two questions involving class certification: (1) whether a defendant in a securities class action may rebut the class-wide presumption of reliance recognized in *Basic Inc. v. Levinson* by pointing to the generic nature of the alleged misstatements (and their consequent failure to negatively impact the issuer's stock price) — even if that evidence also bears on the substantive element of materiality; and (2) whether a defendant bears the burden of persuading the court on the lack of price impact.

In *Allstate*, the Seventh Circuit vacated a class certification order that was based, in part, on the district court's refusal to consider price impact evidence relating to the alleged misstatements. Although the Seventh Circuit acknowledged that Allstate's price impact theory "look[ed] very much like the prohibited defenses of no materiality," it nonetheless concluded that this "close similarity" did not allow the "district court to avoid a price impact defense at the class certification stage." The Seventh Circuit also held, like the Second Circuit in *Arkansas Teachers*, that defendants bear the burden of persuasion in rebutting *Basic*.

With Justice Barrett's elevation, these holdings could become relevant when the Supreme Court considers *Arkansas Teachers* later this term. And looking ahead, Justice Barrett's conservative philosophy may prove influential in several other contexts. To take one example, in the 2014 case *Halliburton Co. v. Erica P. John Fund, Inc.*, three justices — Clarence Thomas, Samuel A. Alito Jr. and Antonin Scalia — were poised to eliminate the *Basic* presumption of reliance altogether. Would Justice Barrett be willing to follow in the footsteps of her mentor, Justice Scalia, and consider overruling *Basic* if such a case were brought before the Court again? Although theoretical at this juncture, these are the kinds of issues that we will be looking out for as the Court ushers in a new, more conservative era.

Supreme Court's Refusal To Grant *Certiorari* in *Jander* May Have Implications for ERISA Stock Drop Litigation

Courts may also have to deal with the implications of another Supreme Court decision, *Retirement Plans Committee of IBM v. Jander*. The January 2020 case is a putative Employee Retirement Income Security Act of 1974 (ERISA) class action that raises an important threshold question: How strict should the pleading standard be for asserting claims against corporate insiders who serve as fiduciaries for employee stock ownership plans?

In *Jander*, the plaintiffs had accused plan administrators, all of whom were insiders, of violating ERISA by failing to disclose allegedly negative information about the purportedly impaired value of IBM's microelectronics business. According to the plaintiffs, these administrators should have understood not only that this nonpublic information would eventually be made public (allegedly because the business was about to be sold), but also that the resulting harm (*i.e.*, a drop in IBM's stock price) would only grow the longer the alleged fraud was concealed. As a result, the plaintiffs complained, any prudent fiduciary would have concluded that waiting to reveal the adverse information would do more harm than good.

In reversing the dismissal of the plaintiffs' complaint, the Second Circuit largely agreed with this framing of the "more harm than good" standard first enunciated in 2014 by the Supreme Court in *Fifth Third Bancorp v. Dudenhoeffer*. Despite granting *certiorari* in *Jander*, the Court declined to issue a decision on the merits and instead remanded the case to the Second Circuit. On June 22, 2020, the Second Circuit reinstated its original decision, effectively leaving intact what some have dubbed the court's "inevitable disclosure" pleading standard.

On November 9, 2020, the Supreme Court denied IBM's new petition for *certiorari*, cementing a circuit split that has continued to deepen. Indeed, in 2020, in *Allen v. Wells Fargo & Co*., the U.S. Court of Appeals for the Eighth Circuit rejected *Jander*'s "inevitable disclosure" test and, in so holding, joined the Fifth and Sixth Circuits in ruling that generalized allegations of nondisclosure, such as those sustained in *Jander*, are legally infirm.

Unless and until the Supreme Court resolves the split, plaintiffs may begin filing ERISA stock drop cases more frequently in the Second Circuit, where they will claim, citing *Jander*, that the pleading standard is more challenging for defendants.

Other Issues To Watch For in 2021

We also will be monitoring how the district courts adapt to other developments in the case law. This includes two 2020 decisions by the U.S. Court of Appeals for the Ninth Circuit that offer guidance on the pleading standards for loss causation. In the first, a putative securities class action against BofI Holding, Inc., the court rejected a categorical rule that allegations from a separate whistleblower lawsuit, standing alone, can never qualify as a corrective disclosure. Instead, the court determined that such allegations can be deemed corrective when the complaint pleads facts from which to plausibly infer that "the market treat[ed] [the allegations] as sufficiently credible to be acted upon as truth." One month later, in a second appeal involving BofI, the Ninth Circuit held that information obtained through a Freedom of Information Act (FOIA) request can be a corrective disclosure if it reveals new facts to the market. In so holding, the court reasoned that because FOIA information is only disclosed by the government if requested, and because not all FOIA requests are granted, courts cannot assume for pleading purposes that information known to government regulators is also known to the market.

Together, these decisions signal that at least in these two areas, involving whistleblower complaints and FOIA requests, courts should eschew bright-line rules in favor of a case-by-case assessment of the plaintiff's allegations.

* * *

Given that securities filings remained at near-historic levels in 2020 despite the disruptions brought by the global pandemic, companies should expect the threat of potential litigation to remain high in 2021.

Biden Administration Signals Its Intention To Be Tougher on Corporate Crime

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BIDEN

Forecasting the enforcement priorities of the Department of Justice (DOJ) under a new administration is difficult at best. However, the Biden administration is widely expected to be tougher on corporate crime than its predecessor, consistent with the approach of prior Democratic administrations. If that is the case, the DOJ's policies and priorities over the past four years that have emphasized individual culpability while incentivizing robust corporate compliance programs presumably will continue unchanged. However, Trump administration policies that arguably reflect a more business-friendly approach to corporate prosecutions will likely be revised or abandoned by the new administration, which is expected to more closely scrutinize and aggressively pursue corporate misconduct, including on the part of financial institutions. In addition, Foreign Corrupt Practices Act (FCPA) investigations, a key enforcement area in the Obama and Trump administrations, are expected to remain a focus, while changing economic realities — including the aftermath of the COVID-19 pandemic — are likely to shape the DOJ's enforcement priorities, at least for the next year.

Emphasis on Individual Culpability

The DOJ's focus on individual culpability in corporate prosecutions was formally announced in September 2015 in the so-called Yates Memorandum, issued by then-Deputy Attorney General Sally Yates. Rod Rosenstein, Yates' successor, stated in late 2018 that pursuing culpable individuals remained a "top priority in every corporate investigation," a claim supported by the annual reports of the DOJ's Fraud Section, which principally prosecutes FCPA, health care fraud and securities fraud cases. The reports show an increase in the number of individuals charged during each year of the Trump administration, from 300 in 2016, the year before he took office, to 478 in 2019. Although 2020 tallies are not yet available, there is no indication that the DOJ's priorities shifted over the past year; for example, the DOJ announced charges against 345 individuals for health care fraud offenses in September 2020. (See "Biden Administration's Expected Impact on Health Care and Life Sciences Enforcement.") There is every reason to believe that the DOJ will continue to prioritize charging individual actors, including culpable corporate officers and employees, in the coming year.

Corporate Prosecutions

With respect to corporate prosecutions, the DOJ's revisions to its policies over the past four years did not constitute a radical shift but rather evidenced a more institution-friendly approach than that of the Obama administration, which more actively prosecuted global financial institutions and in some cases obtained significant penalties. For example, November 2018 revisions to the Yates Memorandum limited the amount and nature of information corporations were required to provide about culpable individuals involved in misconduct in order to receive cooperation credit. A company unable to identify all relevant individuals or provide complete factual information could still obtain cooperation credit if it acted in good faith. A May 2018 policy against "piling on" sought to limit multiagency investigations and fines levied on a company for the same underlying misconduct and directed DOJ prosecutors to consider fines and penalties paid to other enforcement authorities — including foreign authorities — in determining an appropriate penalty. An October 2018 policy concerning the selection of monitors strongly suggested that the DOJ had begun to narrow the set of circumstances requiring a monitor and to limit the role of appointed monitors, particularly with respect to corporate entities with substantial compliance programs and internal controls that appeared sufficient to prevent and remediate misconduct. Recent resolutions of investigations of FCPA and federal fraud statute violations resulting in significant financial penalties did not involve the imposition of monitors, and some of the DOJ's public statements made clear that, in light of companies' enhancements to their compliance programs and internal controls, as well as heightened reporting requirements, monitors were deemed unnecessary.

While the above-referenced revisions to its policies leave the DOJ with substantial flexibility to grant or decline cooperation credit, require a monitor and define its role, and impose appropriate penalties in multiagency investigations, financial institutions and other companies should expect the new department leadership under Attorney General nominee Merrick Garland to closely review these policies and potentially revise them. In light of the new administration's anticipated approach to corporate enforcement, the DOJ may choose to increase the demands on cooperating institutions in providing information about potentially culpable individuals and with regard to requiring monitors with a broad mandate and greater frequency.

The DOJ also may deem more substantial penalties to be warranted in multiagency (and multinational) investigations.

Self-Reporting, Cooperating and Remediating

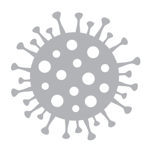
Relatedly, the DOJ issued and clarified policies over the past four years that increased incentives for corporations to voluntarily self-report, fully cooperate and timely remediate. In late 2017, the DOJ updated and codified its April 2016 pilot program, applicable to FCPA investigations, providing a presumption that the DOJ will decline to prosecute any company that takes these steps. Where an enforcement action is warranted despite voluntary self-disclosure — *e.g.*, for pervasive misconduct, executive management involvement or significant resulting profits — the DOJ committed to recommend a 50% reduction in the otherwise applicable fine and generally not to require the appointment of a monitor if the company has an effective compliance program. In early 2018, the DOJ clarified that this policy would serve as nonbinding guidance for all criminal cases. In 2019, the DOJ announced further changes to the policy, relaxing to some extent the requirements that a company must meet in order to receive cooperation credit. The DOJ has highlighted declinations and resolutions consistent with these policies over the past four years, and the Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC) similarly have emphasized the benefits of full cooperation, including declinations, indicating that these agencies may have relied increasingly on self-disclosure over the past four years as a way to efficiently settle enforcement actions.

In the Biden administration, the DOJ, SEC and CFTC, whether acting alone or in coordination, are likely to take a more aggressive enforcement approach toward major banks and corporations and to devote additional resources to the initiation and pursuit of investigations, complementing the voluntary self-disclosure and cooperation policies that are currently in place.

Compliance Programs

Other Trump-era DOJ policies — issued in February 2017, April 2019 and June 2020 — encouraged companies to develop more robust compliance programs. These policies sought to provide enhanced transparency with respect to the DOJ's expectations and evaluation of such programs — a key factor in its determination of whether to prosecute a business organization, the form of any resolution and the amount of any monetary penalty — and to give companies an incentive and opportunity to improve their programs before otherwise seeking aggressive or outsized corporate penalties. Each iteration of the compliance-related guidance arguably raised the bar with respect to the DOJ's expectations of corporate compliance programs. Most recently, in its June 2020 update to its guidance, "Evaluation of Corporate Compliance Programs," the DOJ strongly encouraged prosecutors to assess the efficacy of compliance regimes by considering whether companies have identified and directed their resources to the highest risk areas, tested the effectiveness of their systems by timely and effectively monitoring relevant data sources, and continuously revised and improved their systems in light of "lessons learned." This guidance seems likely to remain in place. In anticipation of a new administration that may redouble its corporate enforcement efforts, companies would do well to familiarize themselves with this guidance, assess their compliance programs in light of it and make any necessary improvements.

Enforcement Priorities



COVID-19

With respect to substantive enforcement priorities, the DOJ is expected to continue to pursue FCPA investigations in the coming year, the source of some of the largest criminal penalties assessed by the DOJ during the Trump administration and, as noted above, a priority of the Obama administration as well. The DOJ almost certainly will continue to police pandemic-related fraud, which it has aggressively pursued since March 2020. Prosecutions arising out of this effort include bank fraud and money laundering cases concerning abuse of the Paycheck Protection Program (PPP) and other Coronavirus Aid, Relief and Economic Security Act (CARES Act) funds. Particularly in light of the recently enacted additional COVID-19 relief legislation, which includes an extension of the PPP, this area should remain a priority. To date, prosecutions have focused on fraud by recipients of such funds, but the Biden Justice Department may expand its focus to include financial institution lenders as well, given its anticipated continuation of several Obama-era priorities. COVID-19 and its aftermath, including its economic impact, may well influence the DOJ's priorities in the coming years.

Impact of Brexit on UK and EU Sanctions Frameworks

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The U.K. adopted an autonomous financial sanctions regime when it exited the European Union on December 31, 2020. The U.K. and EU have both stated that they intend to coordinate post-Brexit sanctions policy as much as possible; with the U.K. historically having been active in shaping EU sanctions policy, we expect it to continue to take a proactive approach under its own regime. The EU, meanwhile, will likely keep a close eye on U.K. actions while also striving for a more robust, uniform enforcement of sanctions across its member states.

Prior to Brexit, the U.K.'s sanctions regime came from the EU, through EU regulations that had direct effect over member states. Now, the U.K. can adopt its own independent sanctions policy, and it has enacted the Sanctions and Anti-Money Laundering Act 2018 (the Sanctions Act) to address how U.K. financial sanctions will operate post-Brexit. The Sanctions Act serves two functions: (1) it enables sanctions to continue uninterrupted by Brexit; and (2) it gives the U.K. government the authority to implement its own sanctions regime.

The first stand-alone U.K. sanctions regime implemented through the Sanctions Act was introduced under the Global Human Rights Sanctions Regulations and came into effect on July 6, 2020. The regulation is intended to deter, and hold people accountable for, activities carried out by or on behalf of a state that amount to serious human rights violations. The EU's equivalent regulation took longer to come into effect, on December 7, 2020, due to the need for member state consensus.

As January 1, 2021, drew closer, the U.K. continued to issue guidance addressing the post-Brexit framework. For example, on November 20, 2020, the sanctions unit of the U.K. Foreign, Commonwealth and Development Office (FCDO) issued guidance covering licenses (which provide permission to act in a way that would otherwise breach sanctions) and sanctions lists (a directory of individuals and entities upon which economic and/or legal restrictions have been imposed). In particular, (1) only licenses granted by the U.K. will be valid in the U.K., and U.K. licenses will not be recognized by the EU in respect of EU sanctions; and (2) the U.K. sanctions list will cover all sanctions made under the Sanctions Act, while the consolidated list of financial sanctions targets from the Office of Financial Sanctions Implementation (OFSI) within Her Majesty's Treasury (HMT) covers all financial sanctions designations. As a result, organizations should make sure they are checking the correct list — some may need to check both — in order to ensure they are compliant with all applicable sanctions regimes.

Also in November 2020, the U.K. published guidance on the legislation enacting U.K. measures similar to the EU Blocking Regulation. The purported effect of the legislation is to "protect UK persons from the extraterritorial effect" of certain laws, including U.S. sanctions on Iran and Cuba. Most recently, in a blog post, OFSI referred to the FCDO's preparations for transition, including the 30 new financial sanctions regulations it has prepared. OFSI stated that although the U.K. regulations are intended to create largely the same policy effects — namely, preserving peace and safeguarding the EU's values, interests and security — as existing EU regimes, they are not identical, and particular care should be taken when assessing whether activities are now compliant with U.K. sanctions.

Post-Brexit, the FCDO is responsible for the U.K.'s international sanctions policy, including all international sanctions regimes and designations. The FCDO will coordinate with OFSI to implement and enforce the U.K.'s financial sanctions on behalf of HMT. The FCDO will publish all listings on the U.K. Sanctions List, which will be in addition to any asset freezes or other types of financial restrictions recorded on OFSI's consolidated list.

From the EU sanctions perspective, Brexit may have serious practical implications. The EU loses not only a determined sanctions advocate but also a well-versed diplomatic corps able to create the consensus needed among member states for the issuance of new sanctions regimes. Consensus can sometimes be difficult to generate due to the number of member states that may be affected economically in different ways. The U.K. has also been a prolific source of intelligence on which the European Council has relied to adopt sanctions that it imposes on specific parties with little collateral damage to other economic actors in the sanctioned party's country and with minimal harm to the EU's domestic economy. It remains to be seen how the EU will fill the void the U.K. left behind. France and Germany are obvious candidates due to the resources available to them, though others such as the Netherlands have played a more active role recently, with a growing enforcement appetite.

Tighter Sanctions Enforcement in the UK and EU?

Historically, EU member states have not actively enforced compliance with EU sanctions laws, possibly due to the lack of an enforcement authority at the EU level, with penalties being set by individual member states, although the U.K. has taken the lead in enforcement since the creation of OFSI in 2016. Post-Brexit, OFSI has indicated that it intends to strike a more aggressive posture against those that breach sanctions. A recent example of OFSI's growing appetite for enforcement is the £20.47 million civil monetary penalty it imposed against Standard Chartered Bank in February 2020 for multiple breaches of EU sanctions against Russia.

OFSI's recent guidance also suggests a more assertive approach to the application and enforcement of sanctions. The guidance outlines a broader jurisdictional scope, meaning that sanctions will apply not only to U.K. citizens but also to U.K.-registered entities and those located within the U.K., as well as persons who "undertake activities" within U.K. territories.

From the EU perspective, it is unclear which member state, if any, will take the lead on investigating and enforcing EU sanctions. Again, Germany and France are possible candidates. Although Germany has not been as active as the U.K. (and still lacks a designated sanctions enforcement authority like OFSI), German courts have made public an increasing number of criminal court proceedings relating to EU sanctions, including those against Russia, Iran, Somalia and the counterterrorism sanctions regime. However, all of these proceedings relate to individuals, and investigations against companies continue to be rare. This may change in the near future if Germany adopts its Corporate Sanctions Act. If passed by the German Parliament, which is likely, the act will require enforcement authorities to initiate investigations against a company whenever the authorities become aware of a potential breach of sanctions by company employees.

While a driving force in EU sanctions policy, France has little sanctions-related case law. To date, its financial regulators have issued only administrative penalties against regulated entities for failing to maintain adequate sanctions-related compliance frameworks. Although it seems unlikely that French sanctions-related investigations will intensify in the near future, French parliamentary reports on the extraterritoriality of U.S. law have increased recently. A June 2019 French report known as the Gauvain report suggests that an EU version of the U.S. Office of Foreign Assets Control (OFAC) could be created to oversee the enforcement by member states of EU sanctions regimes and be a credible counterpart to U.S. authorities in sanctions matters involving a U.S. and EU nexus.

A recent study by the EU Directorate-General for External Policies highlighted the challenges associated with the creation of an "EU OFAC," *i.e.*, the equivalent of the U.S. OFAC sanctions authority, however, there are indications that EU institutions are nonetheless working to address the lack of consistency and clout in sanctions enforcement by EU member states. As with financial sanctions, the European Council's dual-use regulation for export controls is enforced by national authorities at the member state level, with close (and sometimes identical) links to the authorities that enforce sanctions. The proposed regulation, which was presented on November 10, 2020, provides an "enforcement coordination mechanism" designed to support the exchange of information among member states and the European Commission regarding infringements and enforcement measures. Such a mechanism could serve as a first step toward stricter enforcement, and it is possible the EU will continue to follow this approach with future sanctions regulations.

Developments in Delaware Corporation Law

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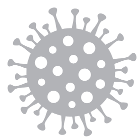
The Delaware Court of Chancery's docket exploded with expedited "broken" deal litigation in 2020, driven by the impact of COVID-19. Beyond pandemic-related merger litigation, stockholder plaintiffs remained focused on claims involving controlling stockholders and increased focus on claims against officers for breaches of the duty of care. There were also significant developments in connection with stockholder statutory books-and-records requests.



COVID-19

Broken Deals

Transaction participants in 2020 faced extraordinary and unprecedented circumstances due to COVID-19. In addition to the crisis' uncertain economic impact, many companies faced employee health concerns and government-mandated shutdowns of core business operations, among other things. (See "US M&A Outlook: Rebounding Market Fuels Optimism for Deal Activity in 2021.") As merger parties grappled with the pandemic and its impact on pending deals, expedited litigation in the Court of Chancery was dominated by broken deals, in which sellers sought to force, and buyers sought to avoid, closing transactions. These cases raised novel contract interpretation concepts, including questions surrounding whether the pandemic constituted a "material adverse effect" (MAE) under the specific language of the deal parties' merger agreements, failures to satisfy conditions caused by the pandemic, and compliance with sellers' interim operating covenants and buyers' best efforts covenants. Many of these cases settled, but several gave rise to noteworthy opinions offering guidance for the future.

In one such case, the Court of Chancery issued a post-trial decision in *AB Stable VIII LLC v. Maps Hotels and Resorts One LLC*. The court held that the buyer was not obligated to close because two conditions — one related to the seller operating in the ordinary course, and the other involving a unique, "factually complex" trademark issue — had not been satisfied. In considering the buyer's arguments that the seller had suffered an MAE, the court addressed a number of arguments that had arisen in similar actions during the year, including whether a carve-out for "general economic conditions" in the definition of MAE could include effects arising from a specific event such as the pandemic (it could) and if the pandemic constituted a "natural disaster" or "calamity" (it did).

Ultimately, in that case, the court concluded that the seller had not suffered an MAE. However, it ruled that the buyer established that the seller failed to comply with its covenant to operate in the ordinary course of business consistent with past practice, explaining that the seller was not permitted to "depart[] significantly" from its "normal range of operations" and rejecting the seller's argument that it was permitted to engage in "ordinary responses to extraordinary events." The case is being closely watched for further developments, as the seller has indicated it intends to move to stay the final judgment pending appeal.

This year, we anticipate merger parties continuing to file broken deal litigation premised on pandemic-related issues, although perhaps with less frequency once the pandemic is considered under control and its impact on the economy and businesses has subsided. More generally, we anticipate seeing broken deal litigation filed in the Delaware courts on a more frequent basis since the court has broken its historic trend of not letting buyers out of deals through litigation. Two cases — *AB Stable* and 2018's *Akorn, Inc. v. Fresenius Kabi AG*, in which buyers were permitted to walk away from their deals based on failed conditions and covenants — could spur more buyers to pursue a litigation option under the appropriate circumstances.

Controlling Stockholders and *MFW* Developments

Transactions involving controlling stockholders continued to be a primary target of plaintiffs in 2020, and the court provided additional guidance on significant issues, including when a stockholder with less than 50% of the company's voting power will be considered a controller. In *Voigt v. Metcalf*, the court concluded that a complaint adequately alleged that a 34.8% stockholder was a controller, citing various indicia of control, including contractual rights to appoint directors and to proportionate representation on board committees, as well as relationships with directors, key executives and advisers. In its ruling, the court also suggested that in many circumstances, "anything over 40% of the voting power is sufficient to prevail" in a stockholder vote. By contrast, in *In re Essendant, Inc. Stockholder Litigation*, the court dismissed claims arising from a merger involving a less than 12% stockholder where it did not nominate directors or "wield coercive contractual rights," among other things.

The Court of Chancery also issued several important rulings applying the Delaware Supreme Court's 2014 seminal decision in *Kahn v. M & F Worldwide Corporation* (*MFW*), which held that a transaction involving a controlling stockholder will be reviewed under the deferential business judgment rule (as opposed to the far more stringent "entire fairness" standard) if it is conditioned *ab initio* on the "dual protections" of approval by both a well-functioning committee of independent and disinterested directors and a majority of the minority stockholders in an uncoerced, fully informed vote. In *In re AmTrust Financial Services, Inc. Stockholder Litigation*, the court declined to dismiss claims arising from a squeeze-out merger, holding that *MFW* did not apply because three of the four special committee members were interested in the transaction given their status as defendants in derivative actions that were extinguished by the merger.

In addition to director independence, the court also focused on *MFW*'s a*b initio* requirement and special committees' role and authority. In *In re Dell Technologies Inc. Class V Stockholders Litigation*, the court held that *MFW* did not apply to a redemption of shares because, among other reasons, procedural protections were not established "at the outset" given that the special committee formed to negotiate the redemption lacked the ability to "say no" under its mandate and the company allegedly bypassed the special committee to negotiate with certain large stockholders directly. In *In re HomeFed Corp. Stockholder Litigation*, the Court of Chancery also denied a motion to dismiss, holding that the complaint adequately alleged that the controlling stockholder failed to "commit to the *MFW* protections before engaging in substantive economic discussions concerning the Transaction." And in *Salladay v. Lev* — which involved not a controlling stockholder but three directors who owned large stakes and agreed to roll over their interests in the surviving company — the court held that *MFW* could not apply to dismiss the action because the dual procedural protections of a special committee and majority-of-the-minority vote were not in place *ab initio* based on early price discussions with the buyer.

In light of these developments, we expect stockholder plaintiffs to continue to closely scrutinize controller transactions, push the envelope on the level of stockholdings that constitute control and seek ways to prevent *MFW* from applying in order to avoid dismissal at the pleading stage. Implementation of procedural protections at the outset of negotiations, director independence and disinterestedness, and adequate disclosures will remain important issues in controlling stockholder litigation in the coming year.

Merger-Related Officer Liability

Until recently, officer breach of fiduciary duty cases were few and far between, notwithstanding that officers are not entitled to the same defenses as directors. Section 102(b)(7) of the Delaware General Corporation Law (DGCL) permits a corporation to adopt a provision in its certificate of incorporation exculpating directors from money damages for breaches of the duty of care, but it does not permit a similar provision for corporate officers. Even so, claims against officers for breaches of the duty of care in merger-related cases were exceedingly rare, with the focus primarily on instances involving a breach of the duty of loyalty.

However, following the Court of Chancery's 2019 decision in *Morrison v. Berry*, which shined a spotlight on officer liability in the merger context, the court witnessed a notable uptick in such claims against corporate officers. Indeed, in *In re Mindbody, Inc., Stockholders Litigation*, the court sustained breach of fiduciary duty claims against a chairman/CEO and a chief financial officer/chief operating officer. It concluded that the complaint supported a reasonable inference that the CEO was conflicted based on an interest in near-term liquidity and an expectation that he would receive post-merger employment, and "failed to disclose material information to the board." The court also concluded that the CFO, who allegedly obeyed the CEO's instructions that aided in tilting the sales process to the buyer, was "at least recklessly indifferent" to the steps the CEO took. In *In re Baker Hughes Inc. Merger Litigation* and *City of Warren General Employees' Retirement System v. Roche*, the court sustained claims against CEOs who signed allegedly misleading merger disclosures. But a number of other cases — including *In re Essendant*, *In re AmTrust Financial Services* and *Rudd v. Brown* — dismissed claims against officers, making clear that plaintiffs must adequately allege both a breach of the duty of care and that the individual against whom they seek to impose liability acted in his or her capacity as an officer and not as a director.

In the coming year, we expect stockholder plaintiffs to continue pursuing claims against officers with increased frequency. We will be closely monitoring the court's approach to merger-related duty of care claims against officers, particularly in connection with their roles in preparing disclosures relating to merger transactions.

Trends in Books-and-Records Litigation

Plaintiff stockholders also remained focused on Section 220 of the DGCL as a vehicle for obtaining corporate documents before commencing litigation. Section 220 permits stockholders of Delaware corporations to inspect books and records where they have identified a "proper purpose" for doing so. Traditionally, Section 220 was used by stockholder plaintiffs as a way to draft and file a more detailed derivative complaint. Given the decrease in M&A injunction requests over the years, and the corresponding decrease in discovery records created for that purpose, stockholder plaintiffs have turned to Section 220 to access documents and communications that might assist them in similarly crafting a post-closing class action complaint to successfully challenge a merger transaction. In that regard, in recent years, plaintiffs have sought books and records not only to bolster derivative complaints but also to raise defenses against the application of *MFW* and *Corwin v. KKR Financial Holdings LLC* (which held that in the absence of a conflicted stockholder, the fully informed vote of disinterested, uncoerced stockholders will extinguish breach of fiduciary duty claims, leaving only claims for waste).

This trend continued in 2020, with most post-closing merger-related cases being filed after stockholder plaintiffs obtained books and records. In one case from February 2020, *Brown v. Empire Resorts, Inc.*, the court ordered Empire Resorts to produce books and records sought to investigate a merger transaction involving its controlling stockholder, requiring the company to produce documents so that the stockholder could, among other things, explore a "gap" between the company's board minutes and proxy disclosures and to "test whether the Empire board and management were motivated during the merger negotiations by the prospects of continued ... employment."

And, in perhaps the most significant Section 220 development, the Delaware Supreme Court curtailed two primary lines of defense against books-and-records inspections. In *AmerisourceBergen Corp. v. Lebanon County Employees' Retirement Fund*, on an interlocutory appeal of a Section 220 demand where the underlying claims would be derivative in nature, the Supreme Court held that, "when the purpose of an inspection of books and records under Section 220 is to investigate corporate wrongdoing, the stockholder seeking inspection is not required to specify the ends to which it might use the books and records." In addition, the court held that a stockholder who demonstrates a credible basis from which the court can infer wrongdoing or mismanagement is not required to show that the wrongdoing or mismanagement is "actionable" — in other words, that it could be susceptible to challenge in a subsequent lawsuit.

This year, we will be closely watching the impact of *AmerisourceBergen* on books-and-records demands. We anticipate *AmerisourceBergen* will encourage litigation-minded stockholders and will result in an uptick of Section 220 demands, and potentially increased litigation in the Court of Chancery over new or recalibrated defenses to such demands.

The State of Congressional Investigations in 2021

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Democrats retained control of the House in November 2020, though the party enjoys a notably smaller majority after losing several seats to Republicans. Additionally, after Democrats prevailed in both runoff elections in Georgia on January 5, 2021, Vice President Kamala Harris can provide the tie-breaking vote to give Democrats the majority in the Senate.

Leadership of the House committees in the 117th Congress, which convened on January 3, 2021, remains largely the same. At least nine Senate committees are slated to have new Republican minority leadership, mostly due to term limits. The majority of Democratic committee chairs for the Senate committees are yet to be announced, though we expect some Democratic members who formerly held Senate minority leadership roles in the 116th Congress to serve as chairs. The three committees that have announced chair changes thus far include the Banking Committee, which Sen. Sherrod Brown will lead. Conventional wisdom suggests congressional oversight of the private sector will increase with Democratic control of both Congress and the executive branch. Both chambers can be expected to pursue similar investigative agendas, as discussed further below.

Absent a crystal ball, it is difficult to anticipate the full scope of issues Congress will choose to examine in 2021. Nevertheless, various predictive sources can assist companies with anticipating topics of congressional interest. For example, the Department of Justice's (DOJ) priorities may shed light on the 2021 congressional agenda, as there is often a great deal of overlap between investigations conducted by the executive and legislative branches, especially where both are controlled by the same party. By way of example, both the DOJ and Congress recently have focused on Big Tech companies' alleged accumulation of market power. (See "Transition From Trump to Biden May Bring Less Change to Antitrust Enforcement Than Expected.") Additionally, recent House hearings have examined the conduct of several generic drug manufacturers charged in an ongoing DOJ criminal antitrust investigation.

Under the Biden administration, corporations can expect the DOJ and congressional investigations to place greater focus on the private sector. Indeed, as noted in greater detail below, Biden's campaign took critical positions on a number of issues directly tied to private commercial activity, including climate change (such as requiring public companies to disclose climate risks), regulation of Big Tech, scrutiny of business relations with China and regulation of financial services (especially with respect to consumer protection issues). Such topics will continue to be important to both the Biden administration and congressional Democrats, and when the interests of the DOJ and Congress align, parallel investigations ensue, creating complex challenges for the private actors caught up in them. Companies find themselves weighing the competing risks and occasionally conflicting demands that such investigations pose.

While we expect many of the DOJ's priorities to continue — Big Tech likely will remain a key focus of both Congress and the DOJ with respect to antitrust, cybersecurity, data privacy and workforce protection — we anticipate additional industries will draw scrutiny. The focus of antitrust enforcement may extend beyond Big Tech to the pharmaceutical and financial services industries. The DOJ currently is in the midst of an ongoing criminal antitrust investigation of generic drugmakers, having charged a seventh company this past summer, and in October 2020, it announced a new "muscular role" for antitrust in financial services, fintech and banking. These priorities align with the incoming Biden administration's stated intention to prioritize protecting consumers from unfair business practices.

Implications of the COVID-19 pandemic will remain a focus of both the DOJ and Congress, including investigations of companies that allegedly took advantage of consumers by price gauging, selling unsafe and/or counterfeit products, and committing fraud.

In addition, President Biden plans to direct the DOJ and the Environmental Protection Agency to place greater emphasis on climate-related issues, such as enforcement of environmental laws — a priority they will likely share with congressional committees. Lastly, the incoming administration likely will continue to concentrate on China (it does not plan immediately to rescind the Trump administration's tariffs on Chinese-made goods) and Russia (especially in the wake of the hack of U.S. government networks in late 2020 attributed to Russian state actors). (See "US-China Trade and Enforcement Issues: What's Next?")

President Biden's legislative platform and anticipated policy priorities also provide insight into the oversight agenda. Congressional Democrats likely will follow the president's lead regarding the following issues and industries:

- **Government Response to the COVID-19 Pandemic:** A great deal of the House's oversight since March 2020 has focused on the Trump administration's management of the COVID-19 pandemic. These investigations likely will continue and be aimed more broadly at such issues as how relief funds were distributed and used, and plans and strategies for responding to future natural disasters and pandemics.
- **Environmental Concerns:** President Biden has made climate change and environmental issues a key priority. As a result, issues such as fracking have received renewed attention. President Biden's recent environmental appointments, including John Kerry as special presidential envoy on climate change and Gina McCarthy as head of the new White House Office of Domestic Climate Policy, also suggest a significantly increased emphasis on environmental issues. (See "Climate Change Should Drive Energy and Environmental Policy.") Key members of the House have signaled their alignment with this presidential priority: The Democrats who were vying to chair the House Appropriations Committee all expressed their plans to work closely with the Biden administration to prioritize federal dollars for fighting climate change. (Rep. Rosa L. DeLauro of Connecticut has been elected chairwoman.) The House can be expected to undertake broad investigations in this space and to conduct oversight of executive branch enforcement of environmental laws, both of which may draw in private actors.
- **Drug Pricing and Health Insurance:** The affordability of health care received significant attention during the 2020 presidential campaign. Furthermore, House and Senate committees have conducted bipartisan investigations of drug pricing over the past few years. Such investigations are expected to continue. (See "Biden Administration's Expected Impact on Health Care and Life Sciences Enforcement.")
- **Tech**: Big Tech has been the recent focus of congressional investigations, and interest in this area is likely to expand as the influence of technology over nearly every aspect of American life continues to grow. In addition to antitrust issues, which have been at the center of many of these investigations, future inquiries may focus on cybersecurity, use of consumer data, website monitoring and social media, reflecting broad societal concerns over privacy issues.
- **Consumer Protection Issues:** Congressional oversight with respect to consumer protection issues featured prominently in 2020, including on e-cigarettes, products containing talc and consumer products created in response to the COVID-19 pandemic. During several hearings, Democrats questioned the drop in enforcement actions at consumer protection agencies under the Trump administration. (See "Fair Lending Enforcement Poised To Increase Under Biden Administration.") Given the bipartisan interest in consumer protection issues, all indications suggest that investigations in this area will feature prominently in Congress' 2021 oversight agenda.
- **2017 Tax Reform Bill:** President Biden has challenged the Trump administration's 2017 tax reform law, asserting that the Tax Cuts and Jobs Act was largely a windfall for large corporations and the wealthy. President Biden also has proposed his own tax plans. Congressional oversight committees may probe companies that benefited from the 2017 tax reform, specifically inquiring about how they spent any tax savings and whether the savings benefited any particular employees.
- **Trump Administration:** Investigations related to President Trump will be a continued priority for Congress. On November 10, 2020, a number of House committee chairs sent letters directing the Trump administration and more than 50 federal agencies to comply with federal record-keeping laws and preserve information responsive to past congressional subpoenas and investigations. Furthermore, following the events at the U.S. Capitol on January 6, 2021, five House committees sent a letter to the FBI seeking a briefing on the agency's efforts to "investigate and pursue for prosecution the instigation, planning, and execution of the deadly terrorist attack on the United States Capitol." Although President Biden has not publicly taken a position on impeachment or the broader agenda of launching investigations into the Trump administration, on

January 13, 2021, the House voted 232-197 to impeach President Trump, accusing him of inciting the insurrection at the Capitol. As of this writing, the Senate impeachment trial is scheduled to begin on February 9, 2021. Numerous Democratic elected officials have argued that impeachment is not enough and have also called for congressional committees and the DOJ to launch investigations into President Trump, his family and his top aides for a host of actions during his time in office, including his challenges to the presidential election.

Statements by chairs and members of key investigative committees have also provided clear previews of oversight priorities:

- Chairwoman Carolyn B. Maloney of the House Committee on Oversight and Reform recently stated that COVID-19, rebuilding the economy, drug prices, the U.S. Postal Service and the census will be top priorities.
- House Committee on Financial Services' Chairwoman Maxine Waters has vowed to continue oversight of megabanks and will strive to reverse the easing of financial rules during the Trump administration, including anti-redlining rules under the Community Reinvestment Act, changes to the Volcker Rule and capital requirements for banks.
- Jerrold Nadler, chairman of the House Judiciary Committee, has stated that the committee will continue its robust oversight of the digital marketplace and its examination of antitrust issues.

Conclusion

In 2020, Congress engaged in significant oversight of the private sector. We can expect such oversight to increase with Democrats controlling both houses of Congress and the executive branch. Companies should monitor relevant press related to potential congressional oversight activities. For example, as noted above, committee chairs and other members often issue press statements indicating priorities of their respective committees. Moreover, oversight letters frequently are released publicly. Reviewing such statements and letters can assist a company in understanding whether the issues outlined therein are unique to them or generally related to industrywide issues, making it possible that other private companies in the industry could be swept up in a congressional investigation. If oversight activity is a possibility, companies should evaluate their policies, procedures and related compliance efforts to determine whether modifications should be made.

Fifth Circuit To Weigh Enforceability of Make-Whole Premiums in Chapter 11

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A recent bankruptcy case now on appeal is being closely watched for the significant economic repercussions it could have on debtors and creditors alike. On October 26, 2020, in *In re Ultra Petroleum Corp.*, the U.S. Bankruptcy Court for the Southern District of Texas held that the debtor must pay (1) the make-whole premium owed under its debt documents and (2) post-petition interest at the contractual default rate.

The decision represents the latest foray by a bankruptcy court into two disputed areas of law that can materially impact creditor recoveries as well as a debtor's flexibility in confirming a plan of reorganization. If it withstands appeal in the U.S. Court of Appeals for the Fifth Circuit, *Ultra* will represent a victory for sophisticated creditors and will become a significant consideration for prospective debtors when evaluating their optimal filing venue.

Background

Ultra Petroleum Corporation is an oil and gas exploration and production company. Between 2008 and 2010, Ultra Resources, Inc. — Ultra Petroleum's operating subsidiary — issued $1.46 billion of unsecured notes under a note purchase agreement and borrowed another $999 million under a revolving credit facility. After a precipitous decline in oil prices, on April 29, 2016, Ultra Petroleum and certain of its affiliates (collectively, the "Debtors") filed for Chapter 11 in the Bankruptcy Court.

During the pending bankruptcy, oil prices rebounded to such a degree that the Debtors became "massively solvent." As a result, the Debtors proposed a plan to pay the creditors under the notes agreement and revolving credit facility (together, the "Funded Debt Creditors") the "outstanding principal owed on those obligations, pre-petition interest at a rate of 0.1%, and post-petition interest at the federal judgment rate." The Debtors argued that this treatment would pay the Funded Debt Creditors in full, leaving them unimpaired and unable to vote on the reorganization plan.

The Funded Debt Creditors objected, arguing that they were impaired because the plan did not provide for payment of the make-whole amount and post-petition interest at the contractual default rate. Under the notes agreement, filing for bankruptcy was an event of default, which entitled the noteholders to the make-whole amount and default interest. The revolving credit facility did not contain a make-whole premium but did require default interest upon filing for bankruptcy. The amounts at stake were significant. The Funded Debt Creditors claimed that the make-whole amount was $201 million and post-petition interest totaled $186 million.

On September 21, 2017, the Bankruptcy Court issued an opinion allowing the make-whole amount and post-petition interest at the default rates. The Bankruptcy Court reasoned that, to be unimpaired, the Funded Debt Creditors must be paid everything they are owed under state law, even if such payments are otherwise disallowed by the Bankruptcy Code. Following a direct appeal by the Debtors, the Fifth Circuit reversed and remanded to the Bankruptcy Court to decide the appropriate post-petition interest rate and whether the Bankruptcy Code disallows the make-whole amount.

Bankruptcy Court's Remand Decision

On remand, the Bankruptcy Court considered two principal questions: first, whether the make-whole amount was disallowed under the Bankruptcy Code because it constituted unmatured interest; and second, whether the "solvent-debtor exception" exists such that a solvent debtor must pay unimpaired, unsecured creditors post-petition interest at the contractual rate.

Make-Whole Amount Issue

The Bankruptcy Court held that the make-whole amount represented liquidated damages, not unmatured interest. Resorting to the ordinary meaning of the term "interest," the court determined that interest means consideration for the "use or forbearance of another's money accruing over time." The make-whole amount compensates the noteholders for any actual loss suffered due to prepayment of the notes — namely, the cost of reinvesting in a less favorable market — and not for the use or forbearance of the noteholders' money. The court observed that, unlike interest, the make-whole amount is a one-time payment that fixes the noteholders' damages at the time of prepayment and does not accrue over time.

In rejecting the Debtors' argument that the make-whole amount was the economic equivalent of unmatured interest, the Bankruptcy Court concluded that a mere reference in a make-whole formula to interest rates does not convert it into the economic equivalent of interest. The make-whole amount was not directly tied to the interest that would have been owed under the notes agreement absent prepayment. Based on the make-whole amount formula, if the "market was substantially more favorable at the time of prepayment, the Make-Whole Amount could equal zero dollars." The make-whole amount therefore approximates the noteholders' damages based on the timing of the prepayment and the applicable reinvestment rate. Because the make-whole amount constituted liquidated damages, not unmatured interest, it was not disallowed under the Bankruptcy Code. Consequently, the Debtors had to pay the make-whole amount in full.

Solvent-Debtor Exception Issue

The Bankruptcy Court held that the solvent-debtor exception exists and therefore requires the Debtors to pay post-petition interest at the contractual default rate. The court offered both historical and equitable support for this conclusion: The solvent-debtor exception has been widely recognized for centuries, including after the enactment of the Bankruptcy Code, and nothing in the legislative history or the Bankruptcy Code "suggests that Congress intended to defang the solvent-debtor exception."

Additionally, the Bankruptcy Court reasoned that the rationale for this exception is rooted in sound equitable principles: A solvent debtor should pay its debts in full before distributing value to shareholders. And to pay a creditor in full, a debtor must pay what is owed under its contractual arrangement with a creditor. Barring unimpaired, unsecured creditors of a solvent debtor from receiving their bargained-for interest would allow a debtor's shareholders "to realize an unjust windfall." Thus, to leave the Funded Debt Creditors unimpaired, the Bankruptcy Court concluded that the Debtors must pay post-petition interest at the default rate as provided for under the notes agreement and revolving credit facility.

Implications

In light of the *Ultra* decision, a company contemplating a bankruptcy filing should closely consider whether the Southern District of Texas is the optimal venue if, under its debt documents, a make-whole premium is owed to its unsecured (or undersecured) creditors upon filing for bankruptcy. The Bankruptcy Court endorsed a narrow view of unmatured interest and its economic equivalents; seemingly, under the *Ultra* decision, it is hard to envisage a make-whole premium that would qualify as unmatured interest (and therefore would not have to be paid by a debtor).

However, it bears noting that the *Ultra* decision rests on a careful analysis of the contractual make-whole language at issue. For example, the Bankruptcy Court emphasized that the make-whole amount was a liquidated damages provision crafted to compensate the noteholders for the cost of reinvesting the prepaid principal at the time of prepayment. Depending on prevailing market interest rates, the make-whole amount could have resulted in no payment at all. There is no guarantee that a make-whole payment that lacks these features will be treated in the same manner. Moreover, the make-whole amount in *Ultra* was triggered by the event of default that occurred when the Debtors filed for Chapter 11, not a prepayment or optional redemption in advance of maturity. This drafting distinction is significant and allowed the noteholders to avoid the issue that disqualified the make-whole payment in the U.S. Court of Appeals for the Second Circuit's 2017 *In re MPM Silicones, LLC* decision, which held that because maturity accelerated to the petition date upon a Chapter 11 filing, the debt could not be prepaid or redeemed.

The final resolution of the *Ultra* make-whole premium dispute is far from complete. The Fifth Circuit issued a decision in January 2019 that, while later withdrawn, is noteworthy because it conflicts with the *Ultra* decision. In it, the Fifth Circuit signaled that make-whole premiums owed to unsecured creditors are, as a matter of law, disallowed under the Bankruptcy Code. How the Fifth Circuit will view the make-whole issue when it returns in the coming year remains to be seen.

US Courts Gain Prominence as 'Anchor' Forum for Enforcing International Arbitration Awards

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A growing number of cases in which private parties are seeking enforcement of very large arbitration awards are percolating through the U.S. courts. These awards emanate both from tribunals seated in the United States (where enforcement is usually governed by the Federal Arbitration Act) and from tribunals seated abroad (where enforcement is governed by international treaties, such as the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards). In either case, once the U.S. courts confirm an arbitration award, it becomes enforceable as a U.S. judgment and the award creditor is generally able to employ U.S. enforcement and discovery procedures in order to locate, and potentially attach, assets of the award debtor. This is a powerful enforcement weapon for award creditors.

The United States is an attractive venue for award enforcement because of its position in the world economy — and, particularly the role of New York as a preeminent banking and financial center — as well as the enforcement processes available in the U.S. courts. In the past, prevailing parties have been aggressive in deploying U.S. judicial enforcement procedures against financial institutions in an attempt to locate and obtain assets of the losing party — even though the financial institutions themselves have no connection with the underlying dispute. The growing number of "mega" awards currently before the U.S. courts suggests that this trend is likely to continue, if not increase.

Over the last few years, a significant number of large arbitration awards (*i.e.*, awards in the billions or hundreds of millions), often involving foreign governments, have been the subject of enforcement proceedings in the United States. A few examples are:

- In 2020, the holders of an International Centre for Settlement of Investment Disputes (ICSID) treaty award of more than $2 billion against Egypt arising from a failed natural gas project brought proceedings to enforce the award before the U.S. District Court for the District of Columbia (DDC). In June 2020, this enforcement petition was stayed pending the outcome of Egypt's application before an ICSID *ad hoc* committee to annul the award. The annulment application remains pending today, and thus the enforcement petition remains stayed.
- An award over $50 billion rendered in 2014 by a Hague-based tribunal, constituted under the arbitral rules of the United Nations Commission on International Trade Law (UNCITRAL) and administered by the Permanent Court of Arbitration is currently the subject of an enforcement proceeding before the DDC. The award was rendered under the Energy Charter Treaty and concerned the expropriation of Yukos Oil, in which the claimants held shares. In November 2020, the court ruled that the enforcement petition would be stayed, pending an application by Russia to the Supreme Court of the Netherlands (the seat of the arbitration) to set aside the award. The award creditors are now seeking to appeal the DDC's stay to the U.S. Court of Appeals for the District of Columbia Circuit. That appeal remains pending.

- A private energy service company's petition to enforce a $6.6 billion London Court of International Arbitration (LCIA) award rendered against the Nigerian Ministry of Energy for unlawful termination of a contract to build a gas processing facility is also pending before the DDC. In December 2020, the court rejected Nigeria's jurisdictional defenses, holding that Nigeria, by ratifying the New York Convention, had waived any defense of sovereign immunity against enforcement. Nigeria is now expected to appeal that ruling to the D.C. Circuit.
- An ICSID Additional Facility treaty award of $1.33 billion in 2016 against Venezuela in favor of Canadian investor Crystallex, Inc., the former owner of an expropriated gold mine, was confirmed by the DDC in 2017. Crystallex then brought further enforcement proceedings in the U.S. District Court for the District of Delaware, and, as a result of various rulings, it is currently seeking to finalize a court order to auction Venezuela's interests in PDV Holding, Inc. (a U.S. company with interests in CITGO) in order to enforce the U.S. judgment.

Legal Battles Over Enforcement

Award enforcement cases can lead to vigorous legal battles among the parties involved, especially where (as in some of the above cases) the award remains subject to set-aside proceedings in the country in which it was rendered and/or annulment proceedings within the ICSID system. In some cases, the courts have been willing to stay enforcement of the award pending the outcome of the proceedings; in others, they have refused to do so — particularly when they find that foreign set-aside/annulment proceedings have been unduly delayed. In still others, the courts have stayed the proceedings only after the losing party posted a bond as security for the award. Where the award debtor is a government entity, foreign sovereign immunity issues also can be significant.

Impact on Third Parties

"Mega" enforcement cases impact third parties — even though they may have had nothing to do with the underlying disputes. Indeed, once an award is confirmed as a U.S. judgment, the award creditor has available to it the full panoply of U.S. judgment enforcement procedures (including third-party discovery). Because award creditors are often well-funded, their enforcement efforts can be far-reaching.

This can present special challenges for international banks and financial institutions, which often receive information subpoenas from award creditors seeking to locate and trace the worldwide assets of an award debtor (*e.g.*, through subpoenas or enforcement notices enforceable in the New York or Delaware federal courts). Such campaigns can give rise to significant disputes over the proper scope of asset discovery subpoenas or freezing orders, particularly when worldwide asset discovery is sought — and/or where the targeted assets are located overseas. Award creditors have, in the past, taken aggressive positions against banks (*e.g.*, seeking discovery and/or attachment of non-U.S. accounts, and/or seeking to have foreign client assets be relocated to the U.S.). Applications such as these, when brought by a well-funded award creditor, can be costly and time-consuming for banks to defend.

Growing Pipeline of Cases

The large, and growing, "pipeline" of substantial arbitration awards being taken to U.S. courts for enforcement, as illustrated in the above examples, can be ascribed to various factors — both general (*e.g.*, long-term global trading patterns, volatility in some energy markets) and specific (*e.g.*, increasing use of investment treaty arbitration as a remedy against asset seizure). These cases are likely to remain a feature of the landscape for some years and will therefore continue to present challenges for litigants, financial institutions and courts alike, as award creditors will continue to seek to attach bank accounts, shareholdings and other assets through judicial proceedings in the United States.

Regulatory

Transition From Trump to Biden May Bring Less Change to Antitrust Enforcement Than Expected

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BIDEN

Conventional wisdom is that Republican administrations tend to enforce the U.S. antitrust laws somewhat less rigorously than Democratic administrations. That wisdom was contradicted in several ways by the Trump administration: Over the past four years, the Department of Justice (DOJ) Antitrust Division and the Federal Trade Commission (FTC) applied novel theories to increase scrutiny of vertical mergers or acquisitions of potential or nascent competitors, particularly in the technology sector. In doing so, they paved the way for continued aggressive enforcement by the Biden administration.

During the Trump years, the Antitrust Division was more aggressive with vertical mergers than past Republican administrations and even sought, but failed, to block AT&T's acquisition of Time Warner. The FTC created a Technology Task Force in February 2019 to investigate potential conduct cases and to review consummated mergers, particularly acquisitions by large, high-tech platforms of startups in adjacent spaces. The FTC created the task force amid growing criticism that the enforcers had been too lenient in reviewing past deals. Soon after, the FTC opened investigations into conduct and prior acquisitions by Google, Amazon, Facebook, Apple and Microsoft, many of which had been cleared by the FTC. The task force became a permanent Technology Enforcement Division, and the FTC sued Facebook in December 2020, alleging a practice of killer acquisitions — buying a nascent competitor or a potential competitor to kill it. The Antitrust Division, meanwhile, sued Google in October 2020, alleging unlawful monopolization of the market for internet search and search advertising — allegations that regulators in Europe made years ago and that the FTC seemingly declined to make during the Obama administration.

Both agencies have sued to block acquisitions on the killer acquisition theory. In March 2018, the FTC challenged the merger of CDK Global and Auto/Mate, alleging that Auto/Mate was an innovative firm whose future competitive significance was belied by its small presence in the market. The companies abandoned the merger rather than litigate. In December 2019, the FTC challenged Illumina Inc.'s acquisition of Pacific Biosciences of California, Inc., a biotech innovator that the FTC alleged was a potential future competitor of Illumina. The FTC not only sued under Section 7 of the Clayton Act, the statute enacted in 1950 specifically to challenge mergers, but also under Section 2 of the Sherman Act, alleging a never-tried theory that the acquisition was the improper act of an alleged monopolist. The companies abandoned the deal after the complaint was filed.

In August 2019, the DOJ tried, but failed, to block the merger of Sabre Corp. and Farelogix in *United States v. Sabre*, where the Antitrust Division argued the killer acquisition theory. More recently, in November 2020, the DOJ sued Visa Inc. to block its acquisition of Plaid Inc. The parties recently abandoned the deal, but the complaint acknowledged that the payments platform and the information technology software developer are not currently competitors. The complaint had alleged that Visa did the deal to prevent Plaid from becoming a competitor. The DOJ sued under both Section 7 of the Clayton Act and Section 2 of the Sherman Act, similar to the FTC's approach in

Illumina. The same theory echoes throughout the FTC's challenge to Facebook's consummated acquisitions of Instagram and WhatsApp brought under Section 2 of the Sherman Act.

In addition to increased enforcement activity by the FTC and DOJ, Congress has shown bipartisan interest in targeting technology platforms through antitrust. In a 450-page report published in October 2020 following an investigation into digital markets, the Democratic majority on the House Judiciary Subcommittee on Antitrust, Commercial and Administrative Law called for legislation to break up large technology firms, overturn court decisions it perceived as barring plaintiffs from prevailing in antitrust suits, and classify certain mergers as presumptively unlawful. The subcommittee called out "dominant" technology firms for this special treatment, recommending that they be required to prove that any transaction, even a vertical merger, is necessary to serve the public interest and that the benefits from the deal could not alternatively be achieved through organic growth. Several members of the Republican minority signed a companion report that, among other things, similarly recommended shifting the burden of proof to favor the plaintiff. The Biden administration's Antitrust Division and FTC are expected to continue to challenge technology deals under novel theories to accomplish through the courts what the subcommittee has recommended. With Democrats controlling the House and the Senate, legislative action is not out of the question, but a statute codifying the subcommittee's recommendation would diverge from decades of legal precedent, which makes it unlikely.

The approach to enforcement by the two current Democratic FTC commissioners perhaps gives the best glimpse into the next four years. Since they were sworn in on May 2, 2018, Commissioners Rebecca Kelly Slaughter and Rohit Chopra have consistently called on the commission to increase its scrutiny of vertical mergers. In dissenting statements, both criticized the June 2020 updated Vertical Merger Guidelines jointly published by the Antitrust Division and the FTC. The guidelines, which had not been updated since 1984, summarize the types of competitive harm the agencies consider when evaluating vertical mergers and describe the types of pro-competitive benefits that lead the agencies to conclude that vertical mergers should not be blocked. The 2020 updates did not break meaningfully from the agencies' historical approach, and the two Democratic commissioners made clear they would have done so. Commissioner Slaughter sought to "disavow the false assertion that vertical mergers are almost always procompetitive," arguing that the guidelines are "inexplicably mute on the well-known and well-supported fact that the potential anticompetitive harms from raising rivals' costs and foreclosure are also 'distinct considerations' in vertical-merger analysis." In his dissent, Commissioner Chopra argued that lax vertical enforcement had stifled competition by creating incentives for startup firms to be purchased by dominant market participants rather than compete to supplant them.

Commissioners Slaughter and Chopra previously dissented in two commission votes not to challenge vertical mergers. When the commission voted to allow Staples, Inc.'s acquisition of Essendant Inc. with behavioral remedies in January 2019, Commissioner Slaughter dissented on the ground that FTC staff had "identified significant evidence of likely harm" and the companies had not "provided evidence showing that the merger's likely harm is offset by cognizable procompetitive benefits." She called for "a requirement that the parties substantiate the magnitude and merger-specificity of the claimed benefits in the same way the Commission endeavors to substantiate theories of harm." Commissioner Chopra noted in his dissent that "[i]ncreased buyer power exerted by the combined firm against its upstream trading partners in this matter would not be an efficiency at all if it stems from an increase in market power on the buy side of the market." A month later, in *In re Fresenius Medical Care*, Commissioner Chopra argued that "vertical mergers in health care markets choke off entry by small startups and other firms" and ultimately hurt patients. Fresenius, one of only two major providers of hemodialysis services through a chain of clinics and related equipment, was buying a company that offered equipment for in-home hemodialysis. He asserted that the acquisition would severely limit the incentive for new entrants in the at-home dialysis market, because one of the two major manufacturers and customers would now have an in-house option.

The more pro-enforcement positions by the Democratic commissioners in these cases, along with the more aggressive actions by the Trump-appointed Republicans at the DOJ and the FTC on vertical mergers and in technology markets, provide a good road map of the type of enforcement that we may see once the Biden administration appoints new leadership at the antitrust agencies. Because of the less conventional approach by the Trump enforcers, we may not see more substantial change from the Biden team than one might ordinarily anticipate when a Democratic administration replaces a Republican one. However, the enforcement posture of the new administration will depend in large part on whether President Biden appoints traditional Democratic enforcers or more aggressive, populist-minded personnel. Prior to his inauguration, the president identified many former officials from the Obama era to serve in his administration, but the approach of the two Democratic FTC commissioners has been more progressive than the Obama-era antitrust convention. With the recent announcements that Chairman Joseph J. Simons will step down on January 29, 2021, and that the new administration plans to nominate Commissioner Chopra to head up the Consumer Financial Protection Bureau, President Biden will have at least two slots to fill at the FTC, in addition to the head of the DOJ's Antitrust Division. In the meantime, Commissioner Slaughter will lead the agency as FTC chairman.

Post-Brexit, a More Demanding UK Merger Review Process

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On January 1, 2021, the U.K. Competition and Markets Authority (CMA) became a merger regulator independent of the European Commission's "one stop shop" for merger control. The CMA has made clear its plans to become "a global competition and consumer protection authority" in reviewing global mergers. The CMA has the tools at its disposal to do so — in the form of highly flexible tests to determine whether the CMA has jurisdiction to review a merger, and powers to impose global freezing orders on merging parties and unwind transactions. With few merger decisions thus far substantively overturned on appeal, the CMA promises to be a competition authority to watch in global M&A in 2021.

The post-Brexit change is significant; the CMA now has the jurisdiction to investigate mergers potentially impacting the U.K., whereas it previously could not pursue cases already under EU review. (See our October 5, 2020, client alert, "Antitrust Planning During the Countdown to Brexit.") The agency has hired new staff and estimates it will review an additional 30-50 transactions per year in its new capacity — a 50% increase on its existing workload.

As with other key competition authorities such as the European Commission, the CMA has stated (in its draft annual plan for 2021-22) its intent to maintain competition in digital markets as a strategic focus: "Digital markets are widely recognised as being one of the most dynamic and innovative areas of most economies. ... It is imperative that we ensure that these markets operate in a way that fosters innovation and growth, and that we remain vigilant to the risk of harm to consumers." Also, the CMA proposes to focus on protecting consumers and driving recovery during and after the COVID-19 pandemic, in addition to taking its place as a global competition and consumer protection authority, among other things.

In the past two years, the CMA has been taking an increasingly assertive stance to merger reviews. It recently reviewed, and in some cases prohibited, a number of global mergers in the digital and life sciences sectors — including mergers where the target appeared to have limited revenues or direct activity in the U.K. The CMA has not been shy about prohibiting transactions where it identifies problems — even where the transactions have been approved by other global authorities — either on antitrust merits or the suitability of proposed remedies. Based on the CMA's published statistics from January to November 2020, 30% of transactions reviewed by the CMA in Phase 1 were moved into an in-depth Phase 2 review (which may take a year or longer). Of those nine Phase 2 transactions, only two were ultimately approved; three were blocked and four others abandoned. By comparison, in the past five to 10 years, an average of around 15% of transactions were moved into Phase 2.

While the increased scrutiny has led to a corresponding uptick in appeals to the U.K. Competition Appeal Tribunal (CAT), claimants have had limited success in overturning a merger decision on its merits. In 2019-20, there were 10 appeals to the CAT relating to merger decisions — almost twice as many as the prior five years. Of the 10, only one was upheld in a material respect (two appeals remain pending). In part this is because, unlike EU merger decisions, where a full review on merits is available, an appellant can only appeal a merger decision by the CMA based on the judicial review standard. An applicant therefore faces an unattractive appellate route for mergers in the U.K. — it must demonstrate that the CMA's application of its broad substantive test and evidential evaluation has been irrational, illegal or procedurally defective, while the CMA is required only to disclose "the gist" of the evidence upon which it has relied to reach its decision.

The CMA's interventionist approach looks set to continue. In its most recent report in November 2020 on the state of competition in the U.K., the CMA noted that the weakening of competition "gives sufficient cause for the CMA, regulators and government to remain vigilant in protecting and promoting competition, especially as the U.K. emerges from the severe economic impact of the pandemic." The CMA also recently issued new guidelines on its assessment of mergers, which include a focus on recently developed theories of harm such as "killer acquisitions" and innovation competition, and also signal the CMA's growing willingness to engage in enforcement in the face of uncertainty when considering the likely effects of a merger. (See our December 3, 2020, client alert, "UK Competition and Markets Authority Has Proposed Updates to Merger Assessment.")

Further reforms on the application of competition rules in the U.K. are also expected. The existing reform proposals by the former chairman of the CMA, Lord Andrew Tyrie, remain on the table, and a new report on competition policy in the U.K. by Member of Parliament (MP) John Penrose is imminent. This report promises to consider how the U.K. competition regime can evolve to promote a dynamic, innovation-driven economy within the context of Brexit and recovery from the impact of COVID-19. One point under deliberation is the introduction of a mandatory merger control regime. Although the current U.K. merger control regime has been voluntary since its inception in 2002, the proposal of a new mandatory filing regime in the context of national security review may pave the way for a further shift in approach. (See "UK Follows Global Trend To Enhance National Security Protections.") Indeed, when it comes to regulating digital markets, the CMA has advised the introduction of a mandatory notification for certain mergers by companies designated as having "strategic market status."

At the same time, the CMA has signaled its intention to cooperate closely with other regulatory authorities from a procedural perspective — which includes potentially not opening an investigation over some global mergers within its jurisdiction where any concerns could be dealt with through another regulator's review. It is not yet clear under which circumstances this type of cooperation would apply; it will likely depend on the strength of the merging parties' nexus to the U.K. and perception of risk of harm based on the sector in which the parties operate. The CMA has also indicated potential flexibility in its process for reviewing remedies in order to fit in with other jurisdictions.

Given recent developments, parties to a merger that may touch on the U.K. (in particular in digital markets) are well advised to consider early on whether the transaction may fall within the jurisdiction of the CMA. Planning in the early stages for a CMA review and the implications that may have on a transaction will be important to the deal timetable and outcome.

Fair Lending Enforcement Poised To Increase Under Biden Administration

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Administrative enforcement and litigation directed toward the consumer financial services industry is expected to increase under the Biden administration, which will likely replace the leadership and senior officials within key agencies, including at the Department of Housing and Urban Development (HUD), the Consumer Financial Protection Bureau (CFPB) and the Department of Justice (DOJ). While this increased enforcement is likely to apply across the board — including with respect to the laws relating to unfair, deceptive, and abusive acts or practices — we expect the most significant increase to be in the area of fair lending enforcement, which was relatively subdued under the Trump administration.

Within the federal system, fair lending enforcement is allocated among numerous agencies. Depending on the entity and the laws involved — such as the Equal Credit Opportunity Act (ECOA) or Fair Housing Act (FHA) — the relevant agencies may include the DOJ, HUD, CFPB or bank regulatory agencies such as the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation (FDIC) and Federal Reserve Board.

Enforcement by Agency

CFPB. The president intends to nominate Rohit Chopra, a former CFPB assistant director and a current commissioner of the Federal Trade Commission, to be the new CFPB director. Under Mr. Chopra, the bureau will likely expand enforcement activity, particularly in the area of fair lending. Enforcement activity had been narrowed somewhat under Director Kathy Kraninger, who resigned on Inauguration Day, and before her, Interim Director Mick Mulvaney. Prior to their tenures, the bureau's first director, Richard Cordray, had implemented an aggressive enforcement posture, including under the fair lending laws, with a particular focus on auto lending, mortgage lending and credit cards. Under Mr. Mulvaney's and Ms. Kraninger's leadership, however, only one enforcement action focused on fair lending (involving allegations of redlining).

DOJ. Like the CFPB, the DOJ had a marked decrease in fair lending enforcement under the ECOA and FHA during the Trump administration. President Biden has nominated Kristen Clarke, who for several years served as the head of the Civil Rights Bureau in the New York Attorney General's Office, to be the assistant attorney general for the Civil Rights Division. Under Ms. Clarke's leadership, we expect to see a return to the levels of activity under the Obama administration, when the DOJ was particularly active not only in pursuing redlining matters but also fair lending cases involving auto, mortgage and unsecured consumer lending.

HUD. HUD enforces the FHA, and like other agencies, was relatively quiet during the Trump administration. One area of focus that we expect to continue, however, is the emphasis on allegedly discriminatory marketing practices. Under Secretary Ben Carson's leadership, for example, HUD brought an action against Facebook alleging that its marketing platform allowed for discrimination in mortgage and housing advertisements on the basis of race, sex and other prohibited factors. We also expect a return to the much higher levels of FHA mortgage lending enforcement activity under the Obama administration.

Other Agencies. The bank regulatory agencies tend to be more consistent from administration to administration than cabinet departments. Nonetheless, as turnover occurs at the top of each agency, it is likely that their enforcement postures will shift toward more intense enforcement of the fair lending laws, in both examinations and formal enforcement proceedings. A summary of the status of each agency is as follows:

- **Office of the Comptroller of the Currency (OCC).** The OCC is responsible for regulating national banks and federal savings associations (thrifts). The president will nominate a replacement for Acting Comptroller Blake Paulson, who is expected to serve in that position on a temporary basis.
- **FDIC.** The FDIC supervises and enforces the law against state-chartered banks that are not members of the Federal Reserve system. Up to four of the five FDIC board members are likely to be replaced by the president.
- The current commissioners of the **Federal Trade Commission** and the governors of the **Federal Reserve Board** have terms extending to 2025 or beyond, making major leadership changes less likely at those agencies in the near term.

Areas of Focus

Across these agencies, we expect to see the following areas of fair lending focus:

- **Loan Servicing and Debt Collection.** Increased defaults attributable to economic strain from COVID-19 have placed servicing practices under the spotlight and could lead to more enforcement and further rulemaking in this area. The CFPB also could revive a rulemaking initiative started under Director Cordray and impose restrictions on the collections practices by first-party creditors that are similar to those in effect for third-party debt collectors.
- **Machine Learning/Artificial Intelligence (AI).** Over the past several years, many creditors have rolled out machine learning and AI techniques for statistical modeling. The fair lending guidance in this area, however, has not kept up. We expect both increased "regulation by enforcement" as well as the potential for additional rulemaking or informal guidance as to best practices in this area, particularly with respect to how to assess and test such models for bias.
- **Limited English Proficiency (LEP).** Industry practices vary widely as to whether marketing, loan documents and phone services are provided in English only or also in Spanish and other languages. Regulators have issued some enforcement actions alleging LEP fair lending violations and unfair, deceptive, and abusive acts and practices, but limited regulatory guidance exists. We expect enhanced regulatory scrutiny and investigations of LEP practices under the new administration as well as further guidance.
- **Auto Finance.** This area had been very active under the Obama administration, particularly with respect to allegations of discriminatory dealer pricing. Congress nullified the CFPB's written guidance with respect to discretionary dealer pricing under the Congressional Review Act in 2018, and federal regulators stopped bringing enforcement actions in this area. The new administration's regulatory agencies may shift their auto finance fair lending focus to other issues such as underwriting, which — along with pricing — had been scrutinized under the Obama administration.

Given the likelihood of increased fair lending enforcement in the Biden administration, financial services institutions should review their fair lending policies and procedures to ensure compliance with applicable laws and regulations, and carefully monitor areas of focus by regulators and enforcement agencies.

As Blockchain Technology and Cryptocurrency Mature, so Do Their Regulation and Enforcement

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While the adoption of blockchain remains in its nascent stages, 2020 was in many ways a defining year for this decentralized technology. The "initial coin offering" wave of 2017 and 2018 gave way to new projects, including those for "stablecoins" (*i.e.*, coins backed by a fiat reserve or other assets, or algorithmically stabilized to create a nonvolatile means of payment and remittance). Innovations in decentralized finance (or "defi") also demonstrate how blockchain-based solutions have the potential to disrupt many aspects of the financial services sector through lower-cost options. In addition, companies in industries from logistics to content distribution continued to explore ways in which blockchain technology can improve their own ecosystems.

The historical evolution of virtual currencies has resulted in an interesting mix of proposed regulations and enforcement activity. Given the industry's past history, regulators view the virtual currency world as fraught with illegal activity that needs to be regulated or curtailed. However, the potential success of legitimate stablecoin projects is influencing various legislative efforts that seek to address concerns regarding their impact on monetary policy. Overall, regulators globally will likely try to find ways to protect consumers without creating regulatory environments so inhospitable they cause technologists to abandon their efforts.

We address below some of the key developments in the past year.

US Cryptocurrency-Related Enforcement Continues To Increase

In 2020, regulators sharpened their focus on cryptocurrency-related enforcement actions. High-profile cases included Department of Justice (DOJ) and Commodities Future Trading Commission (CFTC) actions against BitMEX, a cryptocurrency exchange and derivatives trading platform, for Bank Secrecy Act and CFTC registration violations; Securities and Exchange Commission (SEC) enforcement actions against several prominent digital asset developers and computer programmer and entrepreneur John David McAfee; and a DOJ prosecution and parallel enforcement action by the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) against Larry Dean Harmon, the founder and operator of two alleged convertible virtual currency "mixers" or "tumblers." "Mixing" and "tumbling" are techniques that combine potentially identifiable digital coins with other coins to make it difficult to trace the source, owner or recipient of the first set of coins.

Rulemaking and new guidance seem likely to continue in 2021, as 2020 ended with a flurry of activity:

- On October 8, 2020, the DOJ issued its Cryptocurrency Enforcement Framework, the first comprehensive public statement of the DOJ's approach to investigating and prosecuting cryptocurrency-related crimes. The framework evinces concern about "business models and activities" in the cryptocurrency space that "may facilitate criminal activity," particularly peer-to-peer exchanges and anonymity-enhanced cryptocurrencies.
- On October 23, 2020, the Federal Reserve and FinCEN announced a notice of proposed rulemaking to revise

travel rule regulations, lowering the applicable threshold at which financial institutions must collect, retain and transmit certain information related to international funds transfers and transmittals of funds from $3,000 to $250 and clarifying that the regulations apply to virtual currencies. This rule change would make many more transactions subject to these information requirements. (See our November 10, 2020, client alert, "FinCEN and Federal Reserve Propose To Significantly Lower Threshold for International Funds Transfers Under Recordkeeping and Travel Rules.")

- On December 18, 2020, FinCEN issued another notice of proposed rulemaking that would impose additional reporting, record-keeping and verification requirements on banks and money services businesses with respect to certain virtual currency transactions involving "unhosted wallets" (*i.e.*, wallets in which the user stores their own private keys). (See our January 19, 2021, client alert, "FinCEN Proposes New Reporting, Recordkeeping and Verification Requirements for Transactions Involving Unhosted Wallets.") FinCEN's rationale for the proposed rule is that the inherent anonymity of unhosted wallets makes them more susceptible to use for illicit activity, and data open to public inspection on blockchains does not sufficiently mitigate the risks. FinCEN believes that the record-keeping and reporting requirements imposed by the proposed rule would help combat illicit finance occurring through unhosted wallets. Critics of the proposed rule assert three principal concerns: The rule would not provide meaningful protections against unlawful activity; it would harm unbanked and underbanked populations that stand to benefit most from unhosted wallets; and it could hamper the evolution and adoption of blockchain technology in the United States. A number of prominent cryptocurrency industry players publicly have opposed the proposed rule, and on January 14, 2021, FinCEN extended the comment period for the rule into the start of the Biden administration.
- Passed on January 1, 2021, over the president's veto, the National Defense Authorization Act included the Anti-Money Laundering Act of 2020, which strengthens the government's anti-money laundering capabilities and creates a Bank Secrecy Act whistleblower program. In addition, the legislation explicitly expresses the "sense of Congress" that virtual currencies can be used for criminal activity; includes the term "value that substitutes for currency" in key provisions of the Bank Secrecy Act, thereby codifying FinCEN's long-held position that virtual currency businesses are subject to the act; and directs the Government Accountability Office to study the role of emerging technologies and payment systems, including virtual currencies, in human trafficking, drug trafficking and money laundering. (See our January 7, 2021, client alert, "US Enacts Historic Legislation To Strengthen Anti-Money Laundering and Counterterrorist Financing Legal Framework.")

Although their impact remains to be seen — shortly after President Biden was sworn in on January 20, 2021, the new administration directed a regulatory freeze pending further review —these developments likely foreshadow growing focus on illicit uses of cryptocurrency and ongoing efforts to curb them through both regulation and enforcement.

Proposed Legislation Seeks To Clarify US Digital Asset Regulation

In 2020, U.S. lawmakers from both sides of the aisle introduced new legislation aimed at regulating digital assets. Three such bills, highlighted below, reflect the lawmakers' goal of balancing the need to protect consumers with the need to foster technological innovation and are representative of the types of legislation being contemplated.

Securities Clarity Act

The Securities Clarity Act seeks to clarify that an asset (including a digital asset) does not become a security as a result of being sold or transferred pursuant to an investment contract. The bill is a reaction to the SEC's activity in this space, which, as SEC Commissioner Hester M. Peirce acknowledged in a February 2020 speech, has been criticized for eliding the distinction between a digital asset token and the investment contract under which it is offered. However, in its initial stage, the bill is a noteworthy step toward mitigating the uncertainty around application of the *Howey* test to digital tokens.

Digital Commodity Exchange Act

The Digital Commodity Exchange Act proposes to create a single, opt-in federal regulatory scheme for digital asset trading platforms under the exclusive jurisdiction of the CFTC. The proposed framework, based on the regulatory model for traditional commodity exchanges, aims to remove major regulatory roadblocks for innovators developing new digital asset projects and provide regulatory certainty in cash markets for digital assets while protecting retail consumers. As with the Securities Clarity Act, while it is unclear whether this bill will become law, its introduction will likely spark discussions as to how to improve the current regulatory landscape for cash markets in digital assets and for innovators of digital asset projects.

STABLE Act

The Stablecoin Tethering and Bank Licensing Enforcement (STABLE) Act seeks to fundamentally alter the stablecoin industry. If passed in its current form, it would add significant costs and complexity for market participants, thereby creating significant challenges for stablecoin development in the United States. Specifically, the act would subject prospective issuers of stablecoins to a host of new regulatory obligations, including (1) obtaining a banking charter; (2) following the appropriate banking regulations under the existing regulatory jurisdictions; (3) notifying and obtaining approval from the Federal Reserve, Federal Deposit Insurance Corporation (FDIC) and appropriate banking agency six months prior to issuance and maintaining an ongoing analysis of potential systemic impacts and risks; and (4) obtaining FDIC insurance or otherwise maintaining reserves at the Federal Reserve to ensure that all stablecoins can be readily converted into U.S. dollars on demand.

Financial Stability Board Recommendations on Stablecoins

On October 13, 2020, the Financial Stability Board (FSB) published its high-level recommendations for the regulation, supervision and oversight of stablecoins, which are designed to become common global standards and systemically important as a result. The recommendations call for regulation, supervision and oversight that is proportionate to the risks of "global stablecoins" — those stablecoins that become widely adopted with potential reach and use across multiple jurisdictions. To that end, the FSB sets out 10 recommendations, including that authorities ensure global stablecoins have effective risk management frameworks in place to deal with reserve management, operational resilience, cybersecurity safeguards and anti-money laundering measures. The FSB also recommends that global stablecoins be required to provide transparent information on their stabilization mechanisms and nature and enforceability of any redemption rights to users. In addition, it recommends that they must adhere to all applicable regulatory standards and address risks to financial stability before commencing operation.

We expect that the FSB recommendations are likely to become the bedrock of international cooperation between regulatory authorities as the universe of stablecoins develops. The FSB expects to continue its work over the coming months and to complete its international standard-setting work in relation to global stablecoins by December 2021. In the meantime, we anticipate that individual jurisdictions, such as the U.S. and U.K., will continue to develop their own legal and regulatory regimes.

President's Working Group Statement on Stablecoins

In late December 2020, the President's Working Group on Financial Markets (PWG) released its assessment of the key regulatory and supervisory considerations for stablecoins primarily used for retail payments, which mirror certain of the FSB recommendations. The PWG recognized that stablecoins have the potential to lower payment costs, increase competition and broaden financial inclusion, but it emphasized that they should be designed in a manner that manages risk and maintains the stability of U.S. and international financial and monetary systems. The PWG's key assessments provide a road map for the establishment of a stablecoin in the U.S.

- Stablecoins must meet (1) all applicable anti-money laundering and countering the financing of terrorism obligations and (2) sanctions obligations. The PWG noted that stablecoins designed to permit anonymous or pseudonymous transactions are likely to attract illicit actors;
- Stablecoins should be designed to address potential financial stability risks, including large-scale, potentially disorderly redemptions and general business losses. This includes ensuring a 1-1 reserve ratio and adequate financial resources to absorb losses and meet liquidity needs. U.S. dollar-backed stablecoins should additionally hold the reserve in high-quality U.S. dollar-denominated assets with U.S.-regulated entities and across multiple custodians;
- Stablecoin holders should be entitled to have enforceable direct claims against the issuer or the reserve assets to exchange their stablecoins for the underlying fiat currency on a 1-to-1 basis;
- Stablecoins should ensure operational reliability (such as adequate scalability) and provide cybersecurity and data protection;
- Stablecoins should not undermine confidence in and the stability of domestic fiat currencies. The PWG notes that stablecoins whose value is determined by reference to more than one fiat currency (*e.g.*, multicurrency stablecoins) may require additional protections; and
- Stablecoins operating in the U.S. may need to establish entities within the U.S. or rely on U.S.-regulated entities as intermediaries.

UK Restrictions on Sale of Cryptoassets and Related Products Come Into Force

The U.K.'s Financial Conduct Authority's (FCA) prohibition on the marketing, sale and distribution of crypto-derivatives to retail investors came into force on January 6, 2021. Crypto-derivatives were already subject to the U.K. financial promotion regime, which contained certain exemptions that were relied upon by unregulated service providers in relation to crypto-products. The FCA's policy statement is intended to prohibit the use of these exemptions that enabled the sale of crypto-derivatives to U.K. retail clients by unregulated service providers and to prohibit FCA-regulated service providers from marketing such instruments to U.K. retail investors.

As a result of the new rules, service providers seeking to distribute such cryptoassets in the U.K. will be required to either rely on an exemption specified in the U.K. Financial Promotion Order and receive approval of their marketing material by an FCA-authorized entity before distribution or obtain authorization themselves before carrying out the marketing activity. We expect that the actions of the FCA are the first of many U.K. regulatory developments specifically related to cryptocurrencies, not least as a result of the work of the FSB described above.

Conclusion

We expect that the regulatory momentum that began in 2020 will continue in 2021 as regulators around the world seek to either fit blockchain technology into existing regulatory frameworks or build out new approaches.

Under Biden, Energy Policy May Shift to Carbon Reduction

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Reducing carbon emissions will be a key objective for President Biden. Because the Federal Energy Regulatory Commission (FERC) has broad regulatory control over the electric industry, it may offer the Biden administration opportunities to advance its goal of achieving a carbon-free grid by 2035.

Democratic control of the Senate is unlikely to be a major factor in the administration's efforts. Aggressive legislation on carbon reduction, such as imposing a carbon tax, seems doubtful given the Democrats' narrow margin of control. Regulatory agencies therefore will, in the near term, serve as the administration's primary tool for reducing carbon emissions. Regulation, not legislation, seems set to become the main battleground. Virtually all FERC action, however, is subject to direct judicial review in a U.S. Court of Appeals. Thus, any steps FERC takes to reduce carbon emissions are likely to end up in court.

Senate control, however, will create an easier path for confirmation of presidential appointments. Currently, FERC has three Republican and two Democratic commissioners. The morning after his inauguration, President Biden named Richard Glick as chairman. Republican Neil Chatterjee's term will expire at the end of June 2021, and the Biden administration likely will nominate a new Democratic FERC commissioner to take that seat the moment it becomes available. At that point, the administration will have more complete control over the agency.

Until Commissioner Chatterjee's term expires, the Democrats will hold the power of the chair but remain in the minority when voting. That means the Biden administration will be able to direct the FERC staff and influence FERC's agenda but will not necessarily always have a voting majority to implement that agenda.

In substantive terms, the Biden administration likely will focus its action in two main areas. First, the new FERC probably will be aggressive in taking at least some steps to factor the cost of carbon into the price of electricity. Currently, utilities around the country decide what types of generating resources (*e.g.*, coal-powered or wind-powered generators) to operate based mainly on the incremental cost of running those resources, such as fuel costs. If FERC were to require some estimate of the cost of carbon to be factored into the economics of generating resources, it would sharply disfavor coal-fired resources, while promoting renewable and nuclear generation — all in a manner somewhat similar to a carbon tax, albeit one focused solely on the power industry.

FERC's statutory mandate to regulate the electric industry rests on a New Deal-era statute — the Federal Power Act. The statute is worded in broad and potentially elastic terms, but abundant case law stretching back 80 years might constrain FERC's authority. Under the Biden administration, FERC likely will press the boundaries of that authority in the name of reducing carbon emissions and test whether the courts will limit the ambit of its authority. In some regions, such steps probably will conflict with the views of at least some states. In addition, pricing carbon into the power generation process will be expensive, with the incremental new costs easily identified. If the Biden administration goes down this road, the journey is likely to be controversial and bitterly fought.

Second, FERC probably will seek to add electric transmission facilities to connect new renewable generating resources to the electric grid so that those resources can move their output to consumers. The best places in the country to produce wind-powered and solar-powered generation typically are far from population centers, making transmission critical. While federal authority over the construction of electric transmission is limited, FERC does have substantial control over who will pay the many billions of dollars it costs to build new transmission. In general, adding new electric transmission becomes easier from an economic perspective if the cost of building the facilities is spread as broadly as possible.

The typical rule at FERC has been that the "beneficiaries" of new transmission must pay for the costs of those facilities. From the perspective of reducing carbon, FERC might conclude that the entire country benefits from any electric transmission line built anywhere in the country that increases renewable generation. Such a finding would increase the prospects for adding substantial renewable generation to the nation's resource mix. However, the work would be expensive, and power consumers in, for example, the Southeastern United States likely would object to paying some of the costs to build new transmission to bring renewable generation to, say, the Midwest. Any such decisions surely will be tested in court. But it seems likely that, under President Biden, FERC will test the limits of its statutory authority on judicial review rather than curtail its actions administratively.

Climate Change Should Drive Energy and Environmental Policy

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As reflected in President Biden's $2 trillion climate plan, we expect significant changes in federal energy and environmental policy, driven by a desire to meaningfully address climate change. However, given that the Democrats hold only a slim margin of control in the Senate, the prospect for aggressive legislative action to implement President Biden's campaign promises on this front may be limited. Therefore, we expect to see more unilateral action from the Biden administration, in the form of executive orders (some of which have already been issued) and agency rulemaking.

Key Aspects of the Biden Climate Plan

President Biden's campaign platform included promises of significant action with respect to climate change and clean energy, including:

- legislation that puts the U.S. "on an irreversible path to achieve economy-wide, net-zero emissions no later than 2050";
- efforts to achieve a carbon-free power sector by 2035 by:
  - modernizing and electrifying infrastructure (including major public investment in automotive infrastructure, with a commitment to install 500,000 electric vehicle charging stations);
  - directing a significant share of federal procurement (which the president pledges to increase by $400 million during his first term) toward batteries, electric vehicles and other "clean energy" inputs; and
  - investing $400 billion over 10 years in clean energy research and innovation, including establishing a new research agency focused on accelerating climate-friendly technologies (*e.g.*, wind, solar and battery storage, as well as new technologies such as carbon capture and sequestration, advanced nuclear generation and green hydrogen production); and
- other "decarbonization" actions, such as:
  - requiring federal permitting decisions to consider the effects of greenhouse gas (GHG) emissions and climate change;
  - ending federal support and financing for coal-fired power projects; and
  - halting new oil and gas drilling leases on federal lands and waterways.

Executive Action on Environmental Matters

- **The Paris Climate Agreement.** On his first day in office, President Biden rejoined the Paris Climate Agreement, the international accord the U.S. joined during the Obama administration pursuant to which the U.S. pledged to cut its CO_2 emissions 26-28% from 2005 levels by 2025. Under the Trump administration, the U.S. withdrew from the Paris Agreement effective November 4, 2020. In 2017, the U.S. also halted payments to the Green Climate Fund established under the Paris Agreement, which helps poorer nations invest in renewable energy. Reentry into the agreement will take effect 30 days after formal notice is sent.
- **Oil and Gas Leases on Public Lands.** On President Biden's first day in office, the Department of the Interior issued an order requiring approval from a top political appointee before any new

onshore or offshore fossil fuel authorization on public lands can be issued. This order is in effect for 60 days. In terms of longer-term action, President Biden has called for a temporary moratorium on new oil and gas leases on public lands. This will likely be accomplished by ordering an environmental review of the cumulative impacts of such projects and halting any new leases during that review.

An alternative approach would be to modify royalties to account for climate costs. Under the Mineral Leasing Act and implementing regulations, the secretary of the interior can set the royalty rate for onshore oil and gas and surface coal mines in new leases without going through new rulemaking. The new royalties would only apply to new leases, and therefore, a modification of rates will not have a significant impact if a temporary moratorium on new leases takes effect. Accordingly, this strategy could be utilized in lieu of a moratorium, or after any moratorium has been lifted.

- **The Arctic National Wildlife Refuge (ANWR).** On his first day, President Biden issued a temporary moratorium on all oil-and-gas leasing activities in ANWR. The executive order directed the Department of the Interior to review the oil-leasing program for ANWR and to do a new analysis of its potential environmental impacts. In addition to the temporary moratorium, Democrats have indicated that they support permanent protection against drilling in ANWR, and such protection may be something that President Biden pursues with control of Congress.

- **Renewable Energy.** President Biden has said that he will establish targeted programs to enhance the development of renewable energy projects on federal lands and waterways, with the goal of doubling offshore wind-generating capacity by 2030. We expect that a large part of these efforts will focus on assigning more resources to expedite the permitting process, which was a slow-moving process under the Trump administration.

- **Federal Review of Climate Effects.** We also expect that, under the Biden administration, federal agencies performing environmental reviews will be required to consider the effects of GHG emissions and the impact on climate change in a more significant fashion than had been done previously. In particular, this will likely require relevant agencies to (1) estimate the life cycle of GHG emissions, (2) assess the cumulative climate impacts of similar projects being pursued in order that the total long-term effects of all similar projects are considered, not just the relatively minor impacts from one project, (3) compare GHG emissions to smaller projects rather than to worldwide emissions, since GHG emissions of any one project are always insignificant compared to worldwide emissions and it is thought that comparing emissions to smaller projects will provide a better context for evaluating the impacts on climate change, and (4) consider the social costs of carbon as estimated by the federal government.

- **The Keystone Pipeline.** On his first day in office, President Biden also canceled the construction permit for the Keystone XL oil pipeline.

Potential Rulemakings Focused on Climate Change

The Biden administration will also likely initiate rulemakings to regulate GHG emissions from numerous sources.

- **Power Industry.** Under President Biden, the Environmental Protection Agency (EPA) will likely seek to regulate GHG emissions from the power industry, but the form of that rulemaking is not clear. The EPA could attempt something similar to the Clean Power Plan, which was advanced by the Obama EPA and focused on achieving statewide reductions in GHG emissions. Such a strategy would likely face significant challenges in the courts, however; the U.S. Supreme Court initially stayed the implementation of the Clean Power Plan pending numerous legal challenges, and we expect the current Court would be equally skeptical if Biden proposed a similar approach.

  An alternative approach could be a focus on reductions at plant-specific levels, which could be accomplished by requiring natural gas co-firing or mandating the use of carbon capture technology where available. Another approach would be to reduce GHG emissions through regulations that require drops in other emissions, such as ozone and particulate matter, since reductions in those emissions also decrease GHG.

- **Oil and Gas Industry.** President Biden has called for "aggressive methane pollution limits for new and existing oil and gas operations." This could involve reinstating an information request from 2016 (which the Trump administration rescinded) designed to fill gaps in knowledge about how facilities operate, what equipment they use and what strategies to control methane are feasible. If reinstated, the responses to the information request would be used to craft more stringent regulations, both for existing and new sources, to limit methane pollution from the oil and gas industry.

- **Transportation Industry.** The president has pledged to develop standards "aimed at ensuring 100 percent of new sales of light- and medium-duty vehicles will be electrified and [calling for] annual improvements for heavy-duty vehicles." California's voluntary agreement with five automakers to increase fuel efficiency and limit GHG emissions from automobiles could serve as a model for such standards. We also expect the Biden administration to seek a stay of the current litigation challenging the Safer Affordable Fuel-Efficient Vehicles Rule — which revoked California's power to set its own GHG standards — in anticipation of the rule being rescinded and the state's power reinstated.

Renewed Emphasis on Enforcement and Environmental Justice

Companies should expect a renewed emphasis on traditional enforcement of environmental laws and regulations, with a particular focus on environmental justice.

- **Environmental and Climate Justice Division.** President Biden has said he will create a new Environmental and Climate

Justice Division within the Department of Justice (DOJ). This office would complement the DOJ's existing Environment and Natural Resources Division by increasing criminal prosecutions and other enforcement, supporting climate litigation against fossil fuel companies, addressing legacy pollution and working with the EPA's Office of Civil Rights. President Biden has indicated that part of this division's work will include implementing, to the extent possible with executive action, Sen. Cory Booker's Environmental Justice Act of 2019, which is focused on addressing and eliminating disproportionate environmental and human health impacts on populations of color, communities of color, indigenous communities and low-income communities.

- **Supplemental Environmental Projects.** The Biden administration may also rescind the Trump administration's directive against using supplemental environmental projects (SEPs) in settlements. SEPs are projects with environmental benefits that a regulated party can agree to perform in exchange for a lower penalty when settling alleged legal violations. SEPs have traditionally been popular with both the EPA and the regulated community, and we expect them to return.

Conclusion

The prospects for aggressive legislative action on environmental and clean energy matters seem limited. Accordingly, the Biden administration is likely to utilize executive actions and rulemaking authority — including those highlighted above — to create a foundation for longer-term implementation of the incoming president's broader climate plan, and as a means of supporting ongoing state-level carbon-reduction initiatives. While the programmatic details, implementation steps and funding for these efforts are likely to be the subject of continued disagreement between President Biden's administration and the Republican minority in Congress, the administration nonetheless appears focused on taking swift action to pursue its ambitious climate change and clean energy goals. President Biden has already implemented some of the above executive actions in his first week in office.

Biden Administration's Expected Impact on Health Care and Life Sciences Enforcement

In 2021, the health care industry generally, and the life sciences sector in particular, is evaluating the potential impact of a change in administration on regulatory and law enforcement. Will investigations and enforcement actions increase? Will new regulations that impact sales and marketing efforts be adopted? Will any newly adopted regulations — for example, the recent "most favored nation" rule tying payment for Medicare Part B medications to the lowest price paid by certain other nations — be enforced, repealed, ignored, supplemented or expanded by the Biden administration?

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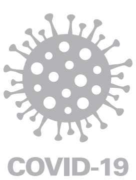
Simple answers do not exist to any of these questions; however, detailed below are our thoughts on what clients should expect under the Biden administration.

Absent a rise in white collar prosecutions, will pursuit of federal health care offenses go up? While all white collar prosecutions dropped between 2013 and 2017, federal prosecution of health care defendants remained roughly at a steady rate that continued during the Trump administration. Most health care offenses are prosecuted by federal prosecutors funded by the Affordable Care Act, which restricts the Department of Justice's (DOJ) ability to shift the focus of those prosecutors to other areas of investigation. Thus, while the Trump administration diverted other resources from white collar investigations and enforcement to immigration and violent crime enforcement, health care prosecutors were not diverted from their congressionally assigned arena. Even without an increase in overall white collar prosecutions under the Biden administration, clients should expect the current level of health care enforcement to continue.

What level of enforcement do you expect from the regulatory agencies overseeing the sector? The DOJ cannot act alone in pursuing a regulatory investigation. If the relevant agencies do not want to pursue enforcement actions, including criminal prosecutions, those actions will wane even with strong DOJ interest. That said, it is likely that the Food and Drug Administration (FDA), the Centers for Medicare and Medicaid Services (CMS), and the Office of Inspector General for the Department of Health and Human Services will be more active in the Biden administration because of Democratic priorities that will push the Biden administration to regulate more heavily than the Trump administration. Even if such regulatory interest does not rise to the level of federal criminal or civil enforcement actions, clients should expect greater regulatory scrutiny during the next four years.

Will federal False Claims Act enforcement increase? With some exceptions, False Claims Act (FCA) enforcement has dropped substantially since 2012, but clients should not expect this slide to continue. Over the past 20 years, FCA enforcement has largely been driven by relators pursuing *qui tam* actions, with the DOJ choosing from among those relators-filed actions which cases to pursue. Clients should expect an uptick in *qui tam* filings, as the relator bar will likely consider the Biden administration's DOJ to be more welcoming to those actions. Another issue to watch for is a potential uptick in the number of FCA actions alleging violations of the FDA's current Good Manufacturing Practice (cGMP) requirements in light of the 2017 case *United States ex rel. Campie v. Gilead Sciences, Inc.*, in which the U.S. Court of Appeals for the Ninth Circuit found that certain alleged violations of the cGMP requirements met the materiality test in the U.S. Supreme Court's *Universal Health Services v. U.S. ex rel. Escobar* decision.

What do we expect with regard to FDA regulatory actions? FDA enforcement actions, especially such regulatory actions as the issuing of warning letters, will likely rise in the next two years once the FDA resumes domestic and international establishment inspections at pre-pandemic rates. Clients should expect the FDA's previous focus on the global supply chain, data integrity and cGMP compliance to continue. There is likely to be increased focus on compliance with combination product requirements as well now that regulations related to post-market adverse event reporting are in effect. The FDA will most likely remain focused on fraud related to COVID-19, and we expect coordination with the Federal Trade Commission and DOJ on efforts to police unapproved therapies making improper health claims. The FDA may also revisit some Trump-era policies related to discrete regulatory issues, such as the regulation of in vitro diagnostics and marketed unapproved drugs.



How will COVID-19 impact the change in administration? Federal, state and local authorities have implemented emergency legislation, regulations and other programs in response to the COVID-19 pandemic. For example, the Coronavirus Aid, Relief and Economic Security Act (the CARES Act) allocated $130 billion in economic programs, tax credits, deferrals and deductions available to companies in the health care industry. Given the significant increase in government spending around COVID-19, we anticipate a corresponding increase in enforcement — a trend that began in 2020 and should continue through the duration of the pandemic, as state and federal enforcement agencies continue to detect, investigate and prosecute COVID-19-related fraud.

Similarly, the FDA continues to actively monitor fraudulent or unproven medical products related to COVID-19, and we expect that enforcement priority to continue under the new administration. Given the FDA's expedited approval of so many products under its Emergency Use Authorization mechanism, more issues in manufacturing and quality are likely, which should also result in more enforcement.

Will new regulations stand? With an evenly divided Senate and a closely divided House of Representatives, congressional action to overrule new regulations seems unlikely. As an example, CMS recently finalized its "most favored nation" pricing model for Medicare Part B drugs, which will primarily impact the branded pharmaceutical industry. There are already several challenges against its enforcement already pending before the courts, which may result in deferred implementation of the rule.

Moreover, because the new regulation has not been finalized for 60 days, it is subject to a memorandum President Biden issued on his first day in office that requires CMS "where appropriate and consistent with applicable law, [to] consider opening a 30-day comment period to allow interested parties to provide comments about issues of fact, law, and policy raised by those rules, and consider pending petitions for reconsideration involving such rules."

Thus, the rule is subject to further review, both by the agency (CMS) and, if that agency considers it appropriate, for further comment as well as potentially a revision or rejection. It is, at this point, impossible to predict whether this particular regulation will be implemented as published in November 2020 or whether it will be further edited or scrapped as a part of any future regulatory processes. It is also possible that, if CMS chooses to scrap the regulation, that decision may be challenged as not "appropriate or consistent with applicable law."

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Companies in the sector should remain vigilant in maintaining ethical corporate cultures and strong corporate compliance programs. Should an increase in regulatory and enforcement commence, both of these attributes should help clients weather the storm.

Changes in Store for Employers Under Biden Administration

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President Biden has made many proposals that will affect employers, including changes to the federal minimum wage, immigration policies, worker classification and other labor laws. Whether those promises are accomplished through legislation, executive action, rulemaking by labor and employment agencies, or some combination of the three, the possible impacts will be significant. Below, we highlight some of the key developments, from initial executive orders issued by the president to other actions that employers might expect to see from the Biden administration over the next four years.

Strengthening Diversity

Executive Order 13985, "Advancing Racial Equity and Support for Underserved Communities Through the Federal Government," was one of President Biden's first official actions in office. It revoked Executive Order 13950, "Combating Race and Sex Stereotyping," which President Trump issued on September 22, 2020. The prior order broadly prohibited federal contractors from conducting workplace anti-bias training dealing with what the order termed "divisive concepts." A September 2020 guidance letter from the Office of Management and Budget stated that such trainings might be identified by searching for terms such as "unconscious bias" and "systemic racism." Business and civil rights groups criticized the order for its lack of clarity and its potential effects on workplace initiatives to combat bias, which were stepped up after noteworthy police killings of Black Americans in 2020. Civil rights groups in December 2020 obtained a preliminary injunction against enforcement of the order from the U.S. District Court for the Northern District of California, in *Santa Cruz Lesbian and Gay Community Center v. Trump.*

President Biden's executive order aims to "advance equity across the Federal Government" and includes an order for federal agencies to identify barriers that underserved communities face in taking advantage of federal contracting opportunities. With President Biden's new order in place, federal contractors may continue to administer anti-bias training to employees in accordance with existing laws.

New Approach to Immigration

President Biden campaigned on a markedly different approach than President Trump on immigration policies, one that highlighted welcoming immigrants, a renewed commitment to assisting asylum seekers and modernizing the immigration system.

For example, President Biden made clear that protection of the Deferred Action for Childhood Arrivals (DACA) program, created under the Obama administration in 2012, is a high priority. DACA allows certain undocumented immigrants known as Dreamers, who entered the United States as minors, to apply for postponement of their deportation in two-year, renewable increments. Those who qualify are eligible for work permits and other federal benefits, such as Social Security and Medicare. The Trump administration rescinded the program in 2017, but in June 2020 the U.S. Supreme Court held in *Dept. of Homeland Security v. Regents of the University of California* that the rescission was invalid. In December 2020, in *Batalla Vidal v. Wolf,* a federal judge in the U.S. District Court for the Eastern District of New York ordered the

Department of Homeland Security to reinstate the DACA policy that was in effect in 2017, including extending one-year employment authorization documents under DACA to two years.

On his inauguration day, President Biden signed an executive order to preserve DACA, which means that the program will continue to be open to new applicants. The Biden administration also is expected to explore options for extending legal status to the family members of Dreamers. (A program by the Obama administration that would have protected parents of DACA recipients was blocked by the courts in 2015.) President Biden supports congressional action that would give Dreamers more permanent protections; with Democrats in control of both Congress and the presidency, such action may now occur.

In addition, the president will likely move to reform the H-1B visa program. The H-1B is a nonimmigrant visa available to skilled workers in specialized occupations who have a bachelor's degree (or equivalent work experience), and it typically is provided to workers in the science and technology industry. The visa is valid for three years, though it is renewable once for a total of six years.

The Trump administration attempted to implement new rules that would have significantly impacted the ability of U.S. employers to sponsor foreign talent in the H-1B visa category. In October 2020, the Departments of Homeland Security and Labor issued interim final rules that limit the occupations eligible for H-1B visas, require employers to pay a higher prevailing wage to visa holders and step up evidentiary requirements for applicants that result in a slower application process. In December 2020, a federal judge in the U.S. District Court for the Northern District of California invalidated these rules on procedural grounds in *Chamber of Commerce of the U.S. v. Dept. of Homeland Security*. In the same month, a second ruling from the U.S. District Court for the District of Columbia, *Purdue University v. Scalia*, similarly invalidated the new rule regarding higher prevailing wages for H-1B workers on procedural grounds. On January 12, 2021, the Department of Labor (DOL) released a new final rule on prevailing wages for certain visa holders, including H-1B workers, attempting to remedy these procedural defects. The wage increases required by the DOL rule are set to take effect in July 2021.

President Biden likely will not pursue a similar crackdown on H-1B visas, although employers should be prepared to respond to new regulatory or legislative changes to the program, including the new rules on prevailing wages. The Biden administration's immigration platform calls for enforcement mechanisms to ensure employment-based visas are not used to undermine wages or to disincentivize recruiting U.S. workers for in-demand occupations.

Wage Increases

President Biden has pledged to raise the federal minimum wage to $15 per hour. A number of states already have enacted minimum wage hikes in recent years, including California, Connecticut, Florida, Maryland, Massachusetts, New Jersey, New York and Washington, among others. Yet the federal minimum wage has remained $7.25 per hour since 2009.

With Congress under Democratic control for the first time since 2011, legislative proposals to raise the federal minimum wage now are more likely to become law. Even without congressional support, President Biden may use executive orders to achieve wage hikes for some employees. His campaign promised to reinstitute the Fair Pay and Safe Workplaces order, which President Obama issued in 2014 and Congress revoked in 2017. Among other things, that order allowed federal agencies to consider a prospective federal contractor's history of compliance with labor laws in awarding contracts. In addition to reinstating the order, President Biden has indicated he would expand it, requiring federal contractors to pay employees at least $15 per hour and provide family-sustaining benefits. The proposal would also limit the use of mandatory employment arbitration by federal contractors and prohibit contractors from running anti-union campaigns. These actions could have noticeable ripple effects, since a significant portion of large employers are federal contractors. It would also represent a major shift from the Trump administration's policies, which set the current minimum wage for federal contractors at $10.95 per hour and supported the repeal of the Fair Pay and Safe Workplaces order. President Biden made an early move toward increasing the minimum wage for certain workers on January 22, 2021, with "Executive Order on Protecting the Federal Workforce," which directs the federal Office of Personnel Management to provide recommendations to promote a $15 per hour minimum wage for federal government employees.

Tougher Standards on Worker Classification

Businesses are awaiting clarity regarding which workers can be classified as independent contractors, particularly those in the gig economy. The Trump administration finalized the DOL's proposed independent contractor classification regulations on January 7, 2021 (which are scheduled to become effective March 8, 2021), but the Biden administration is expected to quickly reverse those rules. Democrats in Congress may also move to repeal the rules through the Congressional Review Act. In the meantime, a general regulatory freeze put in place through a memorandum on January 20, 2021, means the effective date of the rules may be pushed back.

The Trump administration's proposed regulations would alter the "economic realities test," a fact-specific inquiry examining the economic reliance of a worker on the hiring party, which has for years been used to evaluate independent contractor classifications under the Fair Labor Standards Act. The proposed rule's core focus on workers' control over their work would make it easier to establish an independent contractor relationship than the economic realities test, particularly in the gig economy where workers often choose their own hours of work.

President Biden's platform pledges a tougher standard for classifying workers as independent contractors and stepped-up enforcement for misclassification. Under his administration, the DOL likely will move away from the new proposed rule on classification toward a more restrictive view of independent contractor relationships. President Biden has supported the use of the stringent three-prong "ABC test," which was codified at the state level in California in 2019, to distinguish employees from independent contractors. However, given the controversy surrounding the ABC test, which significantly limits the ability to classify workers as contractors, and California voters' recent approval of Proposition 22 — a ballot measure that confirms the independent contractor status of certain rideshare and delivery drivers — it remains to be seen whether the Biden administration will seek to adopt the ABC test at the federal level.

Regardless of what transpires in this area, businesses that use independent contractors should reexamine their level of compliance with laws at the federal and state levels and take steps to minimize misclassification.

New Regime at NLRB

In another Inauguration Day move, President Biden fired National Labor Relations Board (NLRB) General Counsel Peter Robb, who was generally seen as being friendly to management in his interpretations of labor laws. Mr. Robb's firing is an unprecedented move for a president, as Mr. Robb's four-year term was set to expire in November 2021 and no NLRB general counsel has previously been removed. The president also nominated Lauren McFerran, the NLRB's sole Democrat, to be the board's chairperson. In August 2021, President Biden will be able to appoint a Democratic majority on the NLRB, which ultimately is expected to restore a number of precedents reversed by the Trump NLRB. Notably, the Biden NLRB will likely reinstate *Specialty Healthcare* (2011), under which the NLRB presumes a bargaining unit is appropriate when it is composed of employees that perform the same job at the same facility, regardless of whether other employees share a community of interest with that unit. Under this standard, organizing efforts can target a smaller group of employees at a company, sometimes called "micro units." In addition, the Biden NLRB may return to the joint-employer test articulated in the Obama-era decision *Browning-Ferris Industries* (2015). In that decision, the NLRB expanded the joint-employer standard by holding that an entity's status as a joint employer depends on its reserved right to control employees as well as its indirect control over them, as opposed to having only direct control over the employees in question. This joint-employer standard would allow employees to assert a right to bargain with both their direct employer and the company that contracted their services, and has the potential to lead to increased bargaining in many industries.

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President Biden's proposals for a new direction include significant changes to employment and labor law. The way these changes are implemented, as well as their breadth and permanency, remains to be seen, but employers can expect new questions and challenges in the years ahead.

US-China Trade and Enforcement Issues: What's Next?

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As the United States changes administration, there is significant interest in how the country's relationship with China may evolve with respect to trade, national security and government enforcement. Although some modifications in tone and approach under the Biden administration are possible, fundamental changes in these areas appear unlikely.

CFIUS

One of the areas where tensions between China and the U.S. have had a noticeable impact is the work of the Committee on Foreign Investment in the United States (CFIUS) on China-related corporate transactions. This interagency committee, which reviews the national security implications of foreign investments in U.S. companies or operations, has increasingly subjected proposed China-related investments and transactions to heavy scrutiny. This is in response to rising concerns in Washington, D.C. that China may be using M&A and other investments to gain access to sensitive U.S. technology. CFIUS' focus on China began at the end of the Obama administration and intensified considerably under the Trump administration. This caused Chinese direct investment in the U.S. to fall by approximately 89% compared to 2016, according to the U.S.-China Investment Project. More broadly, two-way foreign direct investment flows between the U.S. and China were around $19 billion in 2019, significantly below 2016's record $60 billion.

How much will change in the scrutiny of China-related corporate transactions under the Biden administration remains to be seen. CFIUS may take a slightly more nuanced view of each proposed investment's potential threat to national security, with reduced focus on less sensitive sectors (*e.g.*, commodity products, services or basic manufacturing) that were largely scrutinized based on broader U.S.-China tensions rather than specific national security implications. However, heightened scrutiny will likely continue in areas that involve advanced technology, sensitive personal data and the public sector (*e.g.*, semiconductors, artificial intelligence or machine learning, pharmaceuticals and government contracts) because of the widespread and broadly bipartisan view that loss of the U.S.' comparative advantage would seriously undermine U.S. national security.

The Trump administration also issued a number of executive orders directed at China, including, most recently, "Addressing the Threat From Securities Investments That Finance Communist Chinese Military Companies." Effective January 11, 2021, the executive order prohibits U.S. persons from purchasing securities of certain "Communist Chinese military companies," including 31 companies previously identified by the U.S. Department of Defense. It remains to be seen whether this and other similar executive orders will remain in force under the Biden administration.

Export Controls, Sanctions and Tariffs on China

Over the first few years of the Trump administration, the U.S. put in place significant tariffs against Chinese imports, and China responded with retaliatory tariffs of its own. This cycle of tariffs halted only with the signing of the Phase One Trade Agreement between the U.S. and China in January 2020. Under the agreement, China committed to making structural changes in the areas of intellectual property protection and enforcement, technology transfer, agriculture, financial services and currency. China also committed to increasing its imports of goods and services from the U.S. by at least $200 billion in 2020 and 2021.

Some news reports have suggested that China may seek to renegotiate the Phase One Agreement with the Biden administration. It is unlikely, however, that the administration will agree to changes that weaken China's commitments. Although President Biden has been critical of the tariffs that the Trump administration put in place against China, his administration would likely only remove or reduce the tariffs in return for additional concessions from the Chinese government in areas that have long been a source of tensions, including, for example, the use of industrial subsidies, overcapacity in certain sectors like steel and aluminum, cyber intrusions, and the role of Chinese state-owned enterprises in the economy. The United States has been highly critical of China's policies and practices in these areas because of the unfair advantages they provide to Chinese companies and the adverse effects they have on U.S. companies. The Biden administration would likely seek commitments from China to eliminate and prohibit subsidies that harm U.S. companies, reduce production capacity in key industries, cease engaging in cyber intrusions in the commercial sphere, and ensure that state-owned enterprises act on the basis of commercial considerations and not receive any unfair advantages.

In the area of export controls and sanctions, the Biden administration may take more robust actions when it comes to human rights issues. In addition, the Biden administration may make even more extensive use of withhold release orders to ban imports of products alleged to have been made with forced labor.

DOJ Enforcement

We have previously analyzed the U.S. Department of Justice's (DOJ) China Initiative, launched in November 2018, that promised to dedicate additional government resources to investigating and prosecuting offenses such as trade secret theft and economic espionage involving China. In November 2020, the DOJ announced that it had charged three additional China-related economic espionage cases in the past year, bringing the total number to five since the initiative was first announced. In the past two years, the DOJ has charged more than 10 cases in which trade secret theft had some alleged nexus to China.

In addition, a number of academic and scientific researchers have been charged in the past two years with false statement, fraud, tax or other offenses relating to their nondisclosure or false statements concerning their relationships with the Chinese government. Many of these cases have related to the defendants' involvement with the Thousand Talents Plan, a program by which China, through grants and other inducements, recruits scientists and researchers to work on research projects backed by the Chinese government. (See our April 2, 2020, client alert, "DOJ's 'China Initiative' Uses Scheme-to-Defraud Charges for Nondisclosure of Ties to China.") More prosecutions are likely in the pipeline; according to FBI Director Christopher Wray, his agency opens a new China-related counterintelligence case every 10 hours.

Although the Biden administration may rebrand the China Initiative in response to criticisms that its country-centric focus encourages unfair scrutiny of Chinese or Chinese American individuals, a full-scale retrenchment seems unlikely in the face of the near consensus in the U.S. intelligence and law enforcement communities that the underlying national security threat from China is real. We also can expect the DOJ under the Biden administration to remain aggressive in using the legal tools at its disposal to obtain evidence from individuals and entities subject to U.S. jurisdiction in aid of its China-related investigations and prosecutions.

PCAOB Inspection and China Securities Law

The Biden administration will nominate a new chairperson to replace Jay Clayton, who stepped down as chairman of the Securities and Exchange Commission (SEC) at the end of 2020. Despite the change in leadership, in light of the continuing political and economic tensions between the U.S. and China, SEC scrutiny of U.S.-listed Chinese issuers will likely remain high.

In order for their securities to be listed on a U.S. securities exchange, registrants — whether located in the U.S. or abroad — must comply with registration and reporting provisions that include annually filing with the SEC financial statements audited by an independent auditor registered with the Public Company Accounting Oversight Board (PCAOB). China's state security laws, including those governing the protection of state secrets and national security, have been invoked in recent years to limit the ability of the PCAOB to oversee audit firms in mainland China and Hong Kong.

On December 18, 2020, President Trump signed into law a bill that allows the SEC to ban a foreign issuer's securities from trading on U.S. securities exchanges if the PCAOB is unable to inspect the issuer's accounting firm for three consecutive years. (See our December 3, 2020, client alert, "Holding Foreign Companies Accountable Act Poised To Be Signed Into Law.") The push for more transparency into U.S.-listed China-based issuers is likely to continue unbated during the Biden administration given the strong bipartisan support for such measures. (See "Hong Kong's Exchange Improves Its Allure for Chinese Issuers.")

Adding to the complexity of the securities environment overall is the more active role that the China Securities Regulatory Commission (CSRC) has begun to play in cross-border investigations in enforcing Article 177 of the Securities Law of the People's Republic of China. Effective March 1, 2020, the newly revised law provides that, without the prior approval of the relevant Chinese authority, no entity or individual in China may transmit outside China any documents or materials relating to securities business activities overseas, including to the SEC. An April 2020 statement by the SEC warned investors of the risks of investing in emerging markets and noted that "in China, there are significant legal and other obstacles to obtaining information needed for investigations or litigation." It remains to be seen how the SEC under the Biden administration will work with the CSRC to obtain the information and evidence it needs to investigate U.S.-listed China-based issuers.

With the Biden administration, we expect to see several changes with respect to national security measures, sanctions and export controls, as well as enforcement practices. However, these changes are unlikely to alter the current trajectory of the U.S.-China relationship, as the administration will face continued bipartisan pressure to take strong action when it comes to China.

Major Developments Continue To Reshape the Global Privacy Landscape

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The global privacy landscape has shifted dramatically over the past few years, with 2020 marking a watershed in many respects. The year commenced with the California Privacy Protection Act going into effect and ended with voters passing the California Privacy Rights Act, which will supplement the earlier law and bring the state another step closer to the requirements imposed by the European General Data Protection Regulation (GDPR). Elsewhere, Brazil's Lei Geral de Proteção de Dados Pessoais, modeled after the GDPR, went into effect last year as well, marking another example of robust privacy requirements that global companies need to take into account and that will add to a company's privacy compliance costs. But perhaps the greatest privacy reverberations arose once again in Europe, as a new ruling from the Court of Justice of the European Union (CJEU) created global shockwaves regarding the flow of personal data out of the European Economic Area (EEA).

We examine below some of the key privacy trends from 2020 and the outlook for 2021.

What Happens Next for Data Transfers Outside the EEA?

The CJEU decision in *Data Protection Commissioner v. Facebook Ireland Ltd & Maximillian Schrems* (*Schrems II*) struck down the EU-U.S. Privacy Shield as a valid data transfer mechanism from the EEA to the U.S. after only four years in existence. The EU-U.S. Privacy Shield had been crafted to replace the long-standing "Safe Harbor" agreement the CJEU invalidated in *Schrems I* due to the limitations on the protection of personal data under U.S. law and the disproportionate access and use of EEA personal data by U.S. authorities, with no effective redress mechanism for data subjects. In the July 2020 ruling, the CJEU also imposed enhanced due diligence obligations on parties seeking to rely on the long-standing European Commission Standard Contractual Clauses (SCCs), one of the mechanisms under Article 46 of the GDPR by which personal data can be transferred lawfully outside the European Economic Area, creating uncertainty for those utilizing this common data transfer mechanism.

In October 2020, the CJEU handed down another key decision that will shape the narrative relating to the regulation of data transfers outside the EEA. In *La Quadrature du Net and Others v. Commission*, the CJEU found certain EU member states' national security laws to be incompatible with EEA law. Touching upon the same concern at the heart of the *Schrems II* judgment, in *Privacy International v. Secretary of State for Foreign and Commonwealth Affairs and Others* the CJEU ruled as unlawful member state legislation that allowed electronic communications service providers to indiscriminately store personal data for use or collection by intelligence services.

With these developments in mind, what data transfer developments can we expect in 2021?

- **The Normalization of Transfer Impact Assessments.** In November 2020, the European Data Protection Board (EDPB) released two recommendations addressing the due diligence obligations and supplementary measures imposed by the CJEU in the *Schrems II* decision for organizations transferring data outside the EEA. In line with the recommendations, organizations now must perform case-by-case transfer impact assessments (TIAs) that determine whether the data-importing country provides "essentially equivalent" protection of personal data as that guaranteed under EU law. Where an essentially equivalent level of protection cannot be guaranteed, supplementary technical, contractual and/or organizational measures must be implemented. This creates a new workstream for organizations wherever personal data is transferred outside the EEA on the terms of the SCCs, and TIA templates and policies are likely to become commonplace. What remains to be seen is the form these will ultimately take and how long until any sort of standard approach is developed.
- **Increased Localization Options.** We expect cloud-based service providers that historically transferred EEA personal data to the U.S., or even accessed such data remotely from the U.S. to provide services, to increasingly offer regionalized data hosting and support services within the EEA. For vendors, this may prove a preferable solution to negotiating bespoke supplementary measures with a large number of customers. For customers, the localization of personal data within the EEA eliminates the risk of a court or supervisory authority finding any relevant TIA or supplementary measures inadequate.
- **Implementing New SCCs.** On November 12, 2020, the European Commission (EC) released draft SCCs for transfers of personal data to third countries outside the EEA, which were updated to account for the GDPR and *Schrems II* and to address the need for SCCs governing processor-to-processor and processor-to-controller relationships. Once adopted by the EC, which is expected in early 2021, the updated SCCs will replace the existing ones with a one-year grace period for implementation by organizations. Keeping up-to-date data maps of both intragroup and third-party data flows will facilitate this transition to the new sets of SCCs.
- **Brexit.** Following the Trade and Cooperation Agreement reached between the EU and U.K. on December 24, 2020, data transfers from the EEA to the U.K. will not be considered transfers to a third country for a period of six months and can therefore continue as before, until either (1) the end of the six-month period or (2) the EC reaches a decision on the U.K.'s adequacy. Given the political nature of the adequacy decision, it is difficult to predict with accuracy when the EC will make its decision. With respect to data transfers from the U.K. to the EEA, the U.K. has provisionally recognized the EU as adequate, meaning that data transfers from the U.K. to the EEA can continue as before.

Cookies and Profiling: The Next Enforcement Priorities for European Supervisory Authorities in 2021?

In recent years, various European supervisory authorities have issued guidance on the consent required from users to place cookies or similar technology on user devices, though there was scant enforcement action in this area. That changed in 2020 with a series of cookie-related actions by the French supervisory authority, the Commission Nationale de l'Informatique et des Libertés. Such enforcement activity extends beyond just the French supervisory authority and appears likely to continue in 2021 and should be considered along with the upcoming Digital Services Act, which was published by the EC in December 2020. Among other changes to expand the regulation of large online platforms, the Digital Services Act is expected to increase transparency and user control with respect to profiling. Organizations should take this opportunity to review their practices around cookies and profiling and align them with regulatory standards.

Increased Cost and Complexity for Businesses Under California Data Privacy Laws

In the November 2020 U.S. elections, California voters opted to supplement the privacy rights afforded to them under the 2018 California Consumer Privacy Act (CCPA) with the passage of the California Privacy Rights Act (CPRA). Importantly, the application of both laws is based on whether the data subject is a California resident, not whether an organization has offices in the state. That said, if other states follow California's lead with their own individual privacy laws, demand for a U.S. federal privacy law — which until recently seemed like a remote idea — could gain traction.

The CPRA adds new rights and strengthens certain existing protections for California residents, in many ways affording rights more similar to those of EEA residents under the GDPR, including:

- greater control over the sharing of personal information;
- stricter data minimization requirements;
- enhanced protections for sensitive personal information;
- the right to correct inaccuracies in personal information; and
- greater transparency regarding, and the right to opt out of, the use of automated decision-making technology.

While these changes do not come into force until January 1, 2023, businesses need to take them into account as part of their long-term data monetization and usage strategies.

The CPRA also included several changes that will take place sooner, including increasing resources to enforce California's privacy laws and creating a new California Privacy Protection Agency (CalPPA) with primary responsibility for enforcing the CCPA and CPRA going forward. CalPPA will have authority to coordinate with data protection authorities in California and other jurisdictions, which given the many similarities between rights under the CPRA and GDPR may include regulators in the EU. The California Office of the Attorney General will transfer its regulatory authority to CalPPA upon the earlier of (1) July 1, 2021, or (2) six months after CalPPA provides notice to the attorney general that it is prepared to exercise CCPA regulatory authority. This development answers the question that many had been wondering as to whether the attorney general had the resources to enforce the new privacy laws.

Organizations should expect continuing and, depending on their use of data, potentially increased costs to comply with the CCPA, especially as the California attorney general rolls out new or modified CCPA regulations. In 2020 alone, there were four rounds of adopted or proposed regulations, many dealing with the manner in which companies disclose how they sell consumer data. Longer-term compliance also will remain challenging, as the regulations for the CPRA have yet to be written and the law may be subject to further change before being finalized. Organizations must maintain their current compliance programs while remaining nimble enough to address future requirements.

Priorities To Shift for Biden's SEC

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With the election of Joe Biden in November 2020 and his subsequent nomination of Gary Gensler as the next Securities and Exchange Commission (SEC) chairman, the SEC's regulatory and enforcement priorities are poised to shift this year.

Clayton Fulfills His Mandate

During his January 2017 speech announcing his plan to nominate Jay Clayton as SEC chairman, then President-elect Trump indicated that he expected the Clayton-led SEC to focus on reducing regulatory burdens. In many respects, Chairman Clayton lived up to these expectations, presiding over a record number of final rulemakings (more than 65), many of which aimed to streamline disclosure rules and reduce "friction points" for both public and private offerings. Some of the final rulemaking highlights from 2020 include: expanding the "accredited investor" definition to allow more Main Street investors to access private markets; amending the proxy rules so that the recommendations of proxy advisory firms generally constitute proxy solicitation; and amending the rules, procedures and ownership thresholds for shareholder proposals.

On the enforcement side, the number of actions filed against public companies hit a six-year low in the federal fiscal year that ended on September 30, 2020, although this is likely due to significant disruptions caused by the COVID-19 pandemic. Despite the decline in cases, the SEC set a new record for money collected through enforcement actions (nearly $4.7 billion), including almost $3.6 billion in disgorgement. Notably, on June 22, 2020, the U.S. Supreme Court preserved the SEC's ability to seek disgorgement, holding that the agency may do so in civil enforcement actions in federal court, but any such amounts are limited to the net profits from the alleged wrongdoing. In addition, on January 1, 2021, the National Defense Authorization Act (NDAA) for fiscal year 2021 was enacted into law. Among other things, the NDAA extends the statute of limitations for the SEC to seek disgorgement for scienter-based securities laws violations, such as insider trading, from five to 10 years.

SEC Priorities for 2021

A number of senior SEC leaders — including Chairman Clayton, William Hinman, director of the Division of Corporation Finance, Steven Peikin and Stephanie Avakian, co-directors of the Division of Enforcement, and Raquel Fox,[3] director of the Office of International Affairs — stepped down before the end of 2020. Other departures from the SEC are likely, as is typical in connection with the end of a presidential term. President Biden's SEC will have the opportunity to significantly shape the SEC's regulatory and enforcement priorities as these vacancies are filled. The following are some issues that the SEC may prioritize in 2021.

Regulatory

ESG Disclosure. Calls for greater environmental, social and governance (ESG) disclosure have grown louder in recent years, and some companies, lawmakers and U.S. exchanges are now responding. For example, in December 2020, Nasdaq filed a proposal with the SEC to amend its listing standards to, among other things, enhance diversity disclosures for Nasdaq-listed companies. Similarly, in November 2020, SEC Commissioner Allison Herren Lee made public remarks arguing that the SEC should adopt a disclosure regime "specifically tailored to ensure that financial institutions produce standardized, comparable and reliable disclosure of

3 Ms. Fox is now a partner at Skadden.

their exposure to climate risks." In addition, the Biden campaign published a climate plan that includes "requiring public companies to disclose climate risks and the greenhouse gas emissions in their operations and supply chains," indicating that ESG disclosures — including diversity records and climate risks — are likely to be a high priority for President Biden's SEC. (See "US Corporate Governance: The Ascension of ESG.")

Foreign-Based Issuers. In recent months, companies based in foreign jurisdictions in which the Public Company Accounting Oversight Board cannot inspect audit materials have come under increasing scrutiny. A bipartisan effort by U.S. lawmakers and regulators to require foreign-based issuers to comply with U.S. auditing rules or risk being delisted from U.S. exchanges resulted in the enactment of the Holding Foreign Companies Accountable Act. On December 18, 2020, Chairman Clayton announced that he had asked SEC staff to prepare a unified set of rules and regulations incorporating the terms of the new act. Those are expected sometime this year. (See "Hong Kong's Exchange Improves Its Allure for Chinese Issuers.")

Ultimately, any final rules will be shaped by President Biden's SEC, and the Biden administration may seek a negotiated resolution with individual foreign counterparts instead of pursuing a unilateral approach. Regardless, the focus on and regulatory scrutiny of foreign-based issuers is likely to remain high.

Share Ownership Reporting. Companies and other market participants continue to push the SEC to revise and modernize its share ownership reporting rules. In July 2020, the agency moved to loosen Securities Exchange Act Section 13(f), which requires certain investment managers to disclose their holdings on a quarterly basis. The proposed rules would raise the reporting threshold from $100 million to $3.5 billion worth of securities. If adopted, the change would relieve more than 4,500 investment managers, or 89% of current reporters, of the reporting requirement. The proposal was subject to heavy criticism, with opponents arguing that it would reduce transparency with regard to shareholder bases, allow activist hedge funds to secretly accumulate up to 4.99% of a company's shares and eliminate information on which many stakeholders rely. In October 2020, it was reported that the SEC had scrapped the proposal. President Biden's SEC is likely to examine these and other share ownership reporting rules closely and may ultimately move in the opposite direction by amending the rules to increase disclosure.

Enforcement

Wall Street. During Chairman Clayton's tenure, the SEC concentrated on addressing conduct that specifically harmed Main Street investors. Under the Biden administration, the SEC may refocus its attention more directly on broader Wall Street institutional or market integrity issues. It is not clear, however, how this potential enforcement focus will manifest in enforcement actions.

Insider Trading/Share Repurchases. Although the number of insider trading enforcement actions has trended downward in recent years, President Trump's SEC did bring some notable enforcement actions related to insider trading in fiscal year 2020. In particular, the SEC brought charges against an oil refinery company for allegedly entering into a Rule 10b5-1 share repurchase plan while in possession of material nonpublic information. Ultimately, the matter was settled as an internal accounting controls violation instead of insider trading. The company allegedly used an "abbreviated and informal process" to evaluate the materiality of the nonpublic information it had in its possession, resulting in a decision to proceed with the share repurchases. Although it is unclear whether President Biden's SEC will continue to pursue similar actions on the basis of inadequate internal accounting controls, a continued focus on insider trading matters — a mainstay of SEC activity — is expected.

Disclosure/Disclosure Controls. The SEC has brought a number of cases focused on issuers' risk factors and disclosures in the Management Discussion and Analysis sections of financial statements, as well as some involving other broader disclosure issues. Indeed, issuer reporting and disclosure allegations accounted for 49% of actions brought by the SEC against public companies in fiscal year 2020, according to a Cornerstone Research report. Some highlights include settled enforcement actions against:

- a global conglomerate that allegedly lacked sufficient disclosure controls and procedures and failed to disclose, among other things, that a significant portion of its reported profits came from reducing prior cost estimates;
- a national restaurant chain that allegedly made misleading disclosures concerning COVID-19's impact on its business;
- an energy company that allegedly made misleading disclosures about the status of a $10 billion nuclear power plant project that was eventually abandoned;
- former executives of a multinational financial services company for certifying the accuracy of company disclosures that allegedly contained misleading statements about a key performance indicator for its cross-selling strategy; and
- a high-profile technology company that allegedly failed to disclose certain sales practices that boosted current quarterly sales targets but impacted future sales.

The Enforcement Division's focus on issuer reporting and disclosure is likely to continue under President Biden's SEC.

Takeaways

The SEC's regulatory and enforcement priorities are expected to change under the Biden administration's leadership. These priority changes will likely result in new and revised company disclosure and compliance obligations as well as increased enforcement activity with regard to broader market integrity issues. Companies should stay vigilant and ensure they keep up to date with how the SEC's priorities ultimately unfold under the Biden administration.

Growing Complexity in the Tax Aspects of Transactional Negotiations

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Over the past few years, U.S. tax laws have undergone an unparalleled number of sweeping changes that have profoundly impacted corporate and partnership transactions. The Tax Cuts and Jobs Act (TCJA), enacted in 2017, was the most comprehensive reform of U.S. tax law since 1986. The Coronavirus Aid, Relief and Economic Security Act (CARES Act), enacted in 2020 in response to the COVID-19 pandemic, significantly modified certain aspects of the TCJA, including retroactively in part. Beginning in 2018, the Bipartisan Budget Act of 2015 (BBA) generally subjected partnerships to a new audit regime that includes entity-level income tax assessments in stark contrast to the long-standing principle that income taxes in respect of a partnership are imposed solely on the partners.

The Biden administration has recently taken office with a Democratic-controlled Congress and its own slate of legislative and regulatory priorities, including the promise of additional legislation to address the pandemic's impact on the economy. In anticipation of that, it is useful to take stock of the transformative effect that the BBA, TCJA and CARES Act have had on many tax aspects of corporate and partnership transactions, as it portends the types of novel complexities, opportunities and challenges on the horizon.

Corporate Transactions

One example, among many, of the growing complexity in corporate M&A and restructurings is the treatment of tax attributes, such as net operating losses (NOLs) and interest expense deductions, that often play an important role in pricing and structuring. Prior to the TCJA, an operating loss, including to the extent attributable to interest expense, could generally be used to fully offset taxable income in the year generated. To the extent the loss exceeded that year's income, the resulting NOL could be carried back up to two years or forward up to 20 years to offset taxable income without limitation (assuming no ownership changes that could cause the tax attributes to become subject to the so-called "Section 382 limitation").

Within the relative simplicity of that pre-TCJA regime, if a target corporation were acquired in a stock purchase, the seller and buyer often could, in a relatively straightforward manner, allocate the tax savings attributable to so-called "transaction tax deductions," such as those arising from compensation payments, professional fees and debt financing expenses incurred by the target in connection with the sale transaction. Because transaction expenses typically reduce the price to be paid to the seller, the parties often agreed that the seller should be entitled to any tax refunds generated by the deductible expenses. Carrying back an NOL resulting from such transaction tax deductions to a pre-closing tax period for a cash tax refund was often preferable to carrying the NOL forward to a post-closing tax period, because the carryforward approach would require the parties to either negotiate an upfront payment for the NOL or agree to an often-complicated "pay as you go" approach whereby the buyer paid the seller for the attributes as they were utilized.

Alternatively, if a target corporation had sufficient attributes, the target could fully offset any gain resulting from the sale with its own attributes, and a buyer could acquire the target's business (and obtain a basis step-up that could reduce its own tax liability) by way of an actual or deemed asset acquisition. Such a structure is commonly referred to as a "Bruno's transaction" and is often employed in a distressed sale or bankruptcy restructuring in which a corporation's NOLs are otherwise expected to become devalued as a result of the Section 382 limitation.

Following passage of the TCJA and CARES Act, and regulations promulgated thereunder, calculations regarding the use of tax attributes have become multifaceted, leading to more complex deal negotiations in many transactions. The TCJA effectively segregated pre-2018 NOLs, post-2017 NOLs and post-2017 interest expense deductions into three separate attributes, the latter two of which are subject to new and different limitations and carryover rules. For example, although post-2017 NOLs generally cannot be carried back like pre-2018 NOLs, they generally can be carried forward indefinitely but can offset only a portion (80%) of the taxable income in any year. The same applies to post-2017 interest expense deductions but with a different annual limit than post-2017 NOLs. The CARES Act then created more tranches of these attributes by providing another set of carryback and carryforward rules for NOLs generated in the 2018-20 time frame while temporarily loosening, for certain years, some of the limitations imposed by the TCJA on post-2017 NOLs and interest expense deductions.

The impact of these sweeping legislative changes on negotiating the tax aspects of corporate acquisitions has been significant. It was generally assumed in transactions negotiated after the TCJA, but prior to the CARES Act, that an NOL generated from significant transaction tax deductions could be carried forward only, and negotiations in that regard therefore centered on whether and how the buyer would compensate the seller for the future use of that NOL. The possible approaches have included no payment, upfront payment by buyer to seller at a discounted rate, or future payments by buyer to seller as NOL carryforwards are used in post-closing periods.

Given the TCJA's annual limitation on the utilization of a post-2017 NOL, and the potential for its utilization to offset domestic income taxed at a 21% rate or offshore earnings generally taxed at a 10.5% rate, the negotiations could get elaborate. The CARES Act amplified that complexity by introducing the ability to carry back certain post-2017 NOLs, thereby creating the potential that an NOL resulting from significant transaction tax deductions could be (1) carried back to generate a refund by offsetting pre-TCJA income at a 35% tax rate, (2) carried back to generate a refund by offsetting post-TCJA income at a 21% or 10.5% tax rate, (3) carried forward to be utilized in a post-closing period, or (4) some combination of those. Moreover, the changes made by the CARES Act were retroactive in part, potentially undermining the assumptions made in already-negotiated transactions.

The treatment of Bruno's transactions has shifted under the TCJA and the CARES Act as well. The TCJA instituted an annual limitation on the utilization of post-2017 NOLs and post-2017 interest deductions, creating the potential that the asset-level gain recognized in a Bruno's transaction might not be fully offset by existing attributes regardless of their magnitude. By temporarily removing the TCJA's annual limitation on the usage of NOLs for deals closing in 2020, the CARES Act temporarily revived Bruno's transactions in which asset-gain was fully offset by the seller's attributes. However, given the menu of ways those attributes could potentially be used, detailed analysis and modeling has been required to map out the pros and cons of effectuating a Bruno's transaction as compared to undertaking a different transaction structure that maintains the existing tax attributes.

Future legislation that may be enacted during the Biden administration, combined with newly promulgated regulations, will likely exacerbate the complexities and expand the range of opportunities in the corporate transactional context. In particular, the Biden administration has expressed the desire to provide more pandemic-related stimulus. Given the possibility that such legislation could, similar to the CARES Act, prospectively or retroactively change the TCJA's rules regarding NOLs and interest expense deductions, it would be prudent for acquisition agreements to hedge by addressing a range of possibilities with respect to NOLs and similar tax attributes.

Partnership Transactions

Transactions involving entities taxed as partnerships have been complicated by an assortment of recent statutory and regulatory changes akin to, and at times even more complicated than, those impacting corporate transactions. Although the new audit regime of the BBA has long been anticipated, regulations providing greater clarity were not issued until beginning in 2018, and audits under such regime have only recently begun.

Buyers of partnership interests are now encouraged to broaden their pre-acquisition diligence efforts, given the potential that an assessment for pre-closing taxes could be collected from the partnership after the closing. The BBA contains elective provisions that could mitigate or eliminate that result, including so-called "push-out" elections; however, costs are associated with those mechanisms, and therefore, negotiations around the ability of the partners to trigger their usage are often difficult.

Moving Forward

Predicting future tax law changes and their precise impact on transactions is a difficult task. Nevertheless, it is clear that the interaction between statutory changes made over time (and across different presidential administrations), combined with ever-increasingly complex regulatory guidance, will continue to generate transactional structuring challenges and opportunities that will need to be closely monitored and prospectively taken into account in negotiations.