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Contributing Editors:

Lorenzo Corte & Scott C. Hopkins
Skadden, Arps, Slate, Meagher & Flom LLP

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Expert Analysis Chapters

1 **2021's Most Interesting Developments in M&A**
Adam O. Emmerich & Trevor S. Norwitz, Wachtell, Lipton, Rosen & Katz

7 **Key Drivers and Trends: Digitization, Decarbonization and SPACs**
George F. Schoen & Jenny Hochenberg, Cravath, Swaine & Moore LLP

Q&A Chapters

11 **Australia**
Atanaskovic Hartnell: Lawson Jepps & Sanya Bhatnagar

18 **Austria**
Schoenherr: Christian Herbst & Sascha Hödl

29 **Belgium**
Van Olmen & Wynant: Luc Wynant & Jeroen Mues

36 **Brazil**
Pinheiro Neto Advogados:
Joamir Müller Romiti Alves, Carlos Elias Mercante, Cristina Liu & Camila Otani Nishi

43 **British Virgin Islands**
Walkers: Matthew Cowman & Patrick Ormond

50 **Bulgaria**
Schoenherr (in cooperation with Advokatsko druzhestvo Stoyanov & Tsekova): Ilko Stoyanov & Katerina Kaloyanova-Toshkova

60 **Canada**
Blake, Cassels & Graydon LLP: Markus Viirland & Richard Turner

69 **Cayman Islands**
Maples Group: Nick Evans, Suzanne Correy & Louise Cowley

76 **Croatia**
Vukić & Partners: Iva Sunko & Ema Vukić

83 **Cyprus**
E & G Economides LLC: Virginia Adamidou & George Economides

90 **Czech Republic**
Wolf Theiss: Tereza Naučová & Michal Matouš

98 **Denmark**
Bech-Bruun: Steen Jensen & David Moalem

105 **Finland**
Dittmar & Indrenius: Anders Carlberg & Jan Ollila

112 **France**
Fidal with contributions by Almain:
Stéphanie de Robert Hautequère, Gacia Kazandjian, Sally-Anne Mc Mahon & Geoffrey Burrows

118 **Germany**
Ebner Stolz: Dr Heiko Jander-McAlister, Dr Roderich Fischer, Dr Jörg R. Nickel & Dr Christoph Winkler

126 **Hong Kong**
de Bedin & Lee LLP: Derek Chalmers

134 **Hungary**
Oppenheim Law Firm: József Bulcsú Fenyvesi & Mihály Barcza

141 **India**
Shardul Amarchand Mangaldas & Co.:
Raghubir Menon, Sakshi Mehra, Tanmayee Chaulkar & Rooha Khurshid

150 **Ireland**
Philip Lee LLP: Inez Cullen & John Given

159 **Italy**
NUNZIANTE MAGRONE: Fiorella Alvino & Fabio Liguori

166 **Japan**
Nishimura & Asahi: Tomohiro Takagi & Keiichiro Yamanaka

175 **Luxembourg**
GSK Stockmann: Marcus Peter & Kate Yu Rao

181 **Malaysia**
Azmi & Associates: Norhisham Abd Bahrin & Syed Zomael Hussain

188 **Malta**
DF Advocates: Dr. Maria Paloma Deguara & Celia Mifsud

196 **Montenegro**
Moravčević Vojnović and Partners in cooperation with Schoenherr: Slaven Moravčević & Petar Vučinić

204 **Netherlands**
Houthoff: Alexander J. Kaarls & Kasper P.W. van der Sanden

213 **Norway**
Aabø-Evensen & Co Advokatfirma:
Ole Kristian Aabø-Evensen

228 **Serbia**
Moravčević Vojnović and Partners in cooperation with Schoenherr: Matija Vojnović & Vojimir Kurtić

236 **Singapore**
Bird & Bird ATMD LLP: Marcus Chow & Xing Yi Tan

244 **Slovakia**
URBAN STEINECKER GAŠPEREC BOŠANSKÝ:
Marián Bošanský & Juraj Steinecker

Q&A Chapters Continued

250 **Slovenia**
Schoenherr: Vid Kobe & Bojan Brežan

261 **South Africa**
Bowmans: Ezra Davids & Ryan Kitcat

269 **Spain**
Roca Junyent SLP: Natalia Martí Picó & Xavier Costa Arnau

276 **Switzerland**
Bär & Karrer Ltd.: Dr. Mariel Hoch

284 **Taiwan**
Lee and Li, Attorneys-at-Law: James Huang & Eddie Hsiung

291 **Turkey**
Kolcuoğlu Demirkan Koçaklı Attorneys at Law: Bihter Bozbay İnan, Gözde Zorlu & İrem Cansu Demircioğlu

298 **United Kingdom**
Weil, Gotshal & Manges (London) LLP: David Avery-Gee & Murray Cox

306 **USA**
Skadden, Arps, Slate, Meagher & Flom LLP: Ann Beth Stebbins & Thad Hartmann

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2021's Most Interesting Developments in M&A

Adam O. Emmerich

Trevor S. Norwitz

Wachtell, Lipton, Rosen & Katz

Introduction

The M&A market roared in 2021, bolstered by increasing (and perhaps excessive) optimism about COVID-19 vaccine rollouts, pent-up demand, copious liquidity and significant macroeconomic support. While 2020 was a tale of two cities, with a first chapter marked by a significant number of unsigned pending deals put on hold, and signed transactions broken off because of the uncertainty and impact of COVID-19, dealmakers in 2021 carried forward the dynamic rhythm of the second chapter of 2020 enthusiastically and without pause. In 2021, U.S. deal volume reached $2.6 trillion, a jump of 90% over 2020 and nearly 50% over 2019, while aggregate global deal volume exceeded $6.1 trillion. Companies that had spent 2020 focused on stabilizing operations had increased the appetite for ambitious transactions. Whether the ongoing pandemic, fiscal, monetary and political pressure and uncertainty, and a more difficult regulatory environment around the globe will dampen the deal landscape in 2022 remains to be seen. As this chapter goes to press in early 2022, the M&A market remains robust, including two very large transactions in the online gaming space – Microsoft's acquisition of Activision Blizzard and Take-Two Interactive Software's purchase of Zynga – signaling that strategic players remain willing to pursue big and important deals.

The Top Developments in M&A

Emerging threats to cross-border M&A deals

In recent decades, cross-border M&A has grown as a component of global M&A. Despite all, 2021 was no exception. $1.3 trillion, or 35% of last year's deals (including four of the 10 largest deals), were cross-border, comparable to averages of $1.2 trillion and 35% over the previous 10 years. In the United States, approximately 21% of last year's $1.4 trillion deal volume involved non-U.S. acquirors. Canadian, French, German, Japanese and U.K. acquirors accounted for approximately 49% of the volume of cross-border deals involving U.S. targets, while acquirors from China, India and other emerging economies accounted for approximately 6%.

At the same time, dealmakers are keeping a weather eye on growing challenges to global M&A posed by regulators worldwide. Governments around the world are broadening their regulatory review of foreign direct investment (FDI) beyond the traditional national security focus into a range of other areas, and are becoming more proactive in scrutinizing transactions even if they do not fall within mandatory notification requirements. This trend has been exacerbated by the trade and supply chain vulnerabilities exposed by the COVID-19 pandemic.

In the United States, the Committee on Foreign Investment in the United States (CFIUS), empowered by increased funding and staffing, has continued to scrutinize China-related deals, even for deals with a limited U.S. nexus. Most recently, CFIUS intervened in the attempted purchase by Wise Road Capital, a Chinese private equity firm, of Magnachip, a South Korean semiconductor company. The parties did not initially notify CFIUS of the transaction, as Magnachip's business activities are conducted outside of the United States (though the company is incorporated in Delaware and listed on the New York Stock Exchange). However, after the deal's announcement, CFIUS requested that the parties submit a filing and issued an interim order preventing the parties from closing the transaction pending its review. In December 2021, Magnachip disclosed that CFIUS had identified the proposed transaction as posing national security risks and would recommend against approving the deal. Shortly thereafter, the parties terminated the proposed transaction. Significant U.S. scrutiny is likely to continue in 2022 and onwards, as new bills, such as the Protecting Sensitive Personal Data Act, seek to increase the scope of CFIUS review.

In the United Kingdom, the regulatory decoupling from the European Union has driven a new wave of economic protectionism. For example, in November 2021, the U.K. government asked the Competition and Markets Authority (CMA) to review NVIDIA's acquisition of British chipmaker Arm on national security concerns (the CMA is also conducting an antitrust review). The national security concern has emerged as a surprising new angle in this case, given that NVIDIA is an American-headquartered company. The inquiry is expected to derail initial plans to close the deal by March 2022. Looking ahead, the United Kingdom will continue to place significant scrutiny on deals. In January 2022, the National Security and Investment Act came into force, requiring prior notification and clearance of acquisitions in 17 designated "sensitive" sectors, including technology, communications, emergency services and transport.

Beyond the United States and the United Kingdom, FDI regimes have become more stringent in many countries (Australia, France and Germany being examples) and some countries that have not previously had FDI regimes, like Switzerland and Denmark, are adopting them.

M&A practitioners must recognize foreign investment reviews as a critical area, both due to the impact on the commercial value of a transaction (for example, by limiting the range of viable buyers) and on the uncertainty, including timing, for closing deals.

The denouement of COVID-era litigation

The economic dislocation from the pandemic drove litigation that tested parties' abilities to back out of M&A agreements

signed before the emergence of COVID-19. For the most part, little new law was created, and a buyer must still overcome significant legal hurdles to walk away from a signed public company deal. In 2021, many of the remaining cases were resolved or confirmed.

The *AB Stable* v. *Maps Hotels and Resorts* litigation presented a particularly interesting example of a Delaware court interpreting both material adverse effect (MAE) and interim operating covenants (IOCs) in the pandemic context. In a November 2020 opinion from the Court of Chancery, Vice Chancellor Laster found that the pandemic qualified under the "natural disasters or calamities" exception in the MAE, and the buyer could therefore not walk away from the deal on that basis. However, Vice Chancellor Laster found that the seller's action in response to the pandemic, including closing hotels and limiting operations, violated the IOC requiring the seller to operate the businesses "in the ordinary course of business consistent with past practice in all material respects." Although the court found that the seller's actions were reasonable under the circumstances of a pandemic, the court held that the actions must be assessed in light of the company's preexisting, non-pandemic context. The case was appealed to the Delaware Supreme Court, which issued its opinion affirming the lower court in December 2021. On appeal, the seller argued that the Court of Chancery's interpretation of the IOC inappropriately shifted systemic risks back to the seller, when such pandemic-related risks were allocated to the buyer under the MAE provision. However, the Delaware Supreme Court rejected this argument, holding instead that the MAE and IOCs should be analyzed separately.

While the seller's arguments did not succeed in the *AB Stable* litigation, a Canadian court found arguments in favor of holistic contract interpretation more compelling in *Cineplex* v. *Cineworld Group*. In December 2021, the Ontario Superior Court of Justice awarded Cineplex, a Canadian movie chain, C$1.2 billion in damages for breach of contract by Cineworld Group, which had terminated a signed agreement to acquire Cineplex. The court found that no MAE condition occurred as the parties had carved out an "outbreak of illness." In addition, the court held that the parties' agreement must be read as a whole and, as such, the IOCs could not be interpreted to reallocate risk of the pandemic from the buyer (as set by the MAE provision) to the seller. Under this approach, the court found that the sellers' response to the pandemic, including abiding by legally mandated closures, was in line with the ordinary course of business.

Another Delaware case, *Snow Phipps* v. *KCake*, decided in March 2021, assessed the IOCs in another context. The buyer there argued that the target violated the IOC by drawing down $15 million on its $25 million revolver and implementing labor and operation reductions. The Court of Chancery found no IOC violation based on the revolver drawdown, as the target had previously drawn down the debt facility five times since 2017 and any supposed IOC violation could have been easily cured (particularly if the buyer had provided proper notice of a violation). In addition, the court found that the cost-cutting efforts were in line with the seller's past practice of reducing costs in tandem with declining sales and, thus, the target's operational changes did not violate the IOC. While the *AB Stable* case surprised many M&A practitioners with its buyer-friendly approach to IOC compliance during "black swan" events, which seems to run counter to well-established MAE law, *Snow Phipps* reaffirms that a seller can use past practice as a reasonable defense for operational changes in Delaware litigation.

SEC rulemaking could impact M&A

Some of the rulemaking efforts by the SEC over the course of the past year appear to facilitate greater shareholder activity and potentially bolster the interests of activists (including activist investors). These regulatory moves could stimulate or advance activism campaigns at companies, which in turn may have an impact on M&A.

Significantly, after a long gestation period, the SEC announced final rules requiring universal proxy cards to be used in all contested elections starting in late 2022. Under the new rules, all valid director candidates will be listed on both the company proxy card and the dissident proxy card, and shareholders will be able to pick and choose among the candidates to build their preferred board. Candidates receiving the highest number of votes will be elected where plurality voting applies. Under existing rules, shareholders who vote by proxy generally face a binary choice between management and dissident slates (as a proxy card generally cannot include a nominee who has not consented to being named). This change is expected to enable activists to more easily gain footholds on boards of directors, particularly in cases where otherwise investors would have voted only for the company slate. As a result, companies may come under increased pressure from activist shareholders to sell themselves, break themselves up or engage in other M&A transactions.

It also remains to be seen whether the SEC will finally address gaps in and abuses of the outdated 13D early warning disclosure regime, as many (including our firm) have been urging for years. The current rules continue to allow activist investors and those acting in concert with them to use derivative instruments, loose alliances and extended disclosure windows to build influential, sometimes even effectively controlling, blocks of stock in target companies before disclosing their interest. The SEC has, however, proposed rules that would require the disclosure of derivative positions, which would help companies and investors know when a potentially hostile bidder or activist is building a position.

The SEC has also adopted interpretations of the proxy rules relating to shareholder proposals that will encourage more shareholder activism on environmental, social and governance matters. Although the relevance of these changes to M&A is more attenuated, governance proposals benefiting from this new approach could influence M&A activity in the medium to long term.

Big is bad: the new antitrust enforcers

The Biden Administration has made antitrust enforcement a central plank in its regulatory agenda. In July 2021, the president issued an executive order creating the White House Competition Counsel, and directed federal agencies to rectify "Federal Government inaction [which] has contributed" to "excessive market concentration."

The Federal Trade Commission (FTC) and the Department of Justice (DOJ) Antitrust Division have set out an aggressive agenda to rethink merger approval. In particular, the agencies have noted their joint plans to revise the Horizontal and Vertical Merger Guidelines, "with the goal of updating them to reflect a rigorous analytical approach," and "to review mergers with the skepticism the law demands." In a September 2021 memo, FTC Chair Lina Khan highlighted a desire to "address rampant consolidation" and "scrutinize dominant firms." While the contours of the FTC's more aggressive approach are still largely undefined, the messaging thus far serves as a warning shot to deals that raise potentially significant antitrust issues.

Regulators' actions have already injected a level of unpredictability and greater opposition to deals. Traditionally, the FTC would rarely use its authority to investigate and challenge transactions after the 30-day waiting period from the time of filing. However, the FTC has cited the "tidal wave of merger filings" as straining the agency's capacity. In the last six months of 2021,

the agency issued letters warning parties against closing transactions while investigations remained ongoing, even when the statutory waiting period had elapsed. Similarly, the DOJ has appeared to take more aggressive, deal-killing stances – most prominently, the filing of a DOJ antitrust complaint preceded the unwinding of Aon's proposed $30 billion acquisition of Willis Towers Watson. Other recent high-profile deals that have been the subject of regulatory blocking efforts include NVIDIA's $40 billion purchase of Arm, Illumina's $7 billion takeover of Grail and Penguin Random House's $2 billion deal for Simon & Schuster.

In a rare instance of bipartisan agreement, congressional leaders have continued to push for increased enforcement. Dealmaking parties should expect closer and more prolonged antitrust reviews and, in high-visibility sectors, such as technology, banking and healthcare, a significantly more extensive review process. The same can certainly be said of antitrust regulators around the globe.

In addition to significantly adding risk and dragging out the timelines of large transactions, the tougher antitrust stance is likely to strengthen the hand of private equity players, as such parties usually face reduced scrutiny compared to strategic acquirors that may raise concerns around market concentration.

Another boom year for private equity

Private equity firms rode the dealmaking wave to new heights in 2021, with over 7,000 deals valued at over $650 billion in the United States and over 21,000 deals valued at $1.6 trillion globally. Institutional investors continued an ongoing rebalancing towards private equity investments, as low interest rates continue to weigh down returns in other asset classes.

Growth equity, representing a middle ground between venture capital and private equity, has emerged as a particularly fast-growing segment. These investments typically focus on more mature privately held companies than the traditional early-stage recipients of funding from Sand Hill Road firms. TPG, an early mover in the space, recently spotlighted the strategy as a key growth area in its filings to go public.

With large amounts of dry powder left to deploy, private equity is also ready to piggy-back on a potential upswing in corporate carve-outs. During the pandemic, many companies took on debt and relied on government support to avoid distressed, or near-distressed, transactions. In 2022, as government support is expected to further recede and interest rates rise, additional companies may seek asset sales to raise cash, with private equity buyers frequently among the leading potential suitors.

ESG: a new influence on M&A

In the wake of the pandemic, ESG-oriented investments have reached record heights. Investors, and increasingly regulators have continued to pressure companies to enhance their oversight and management of ESG risks and opportunities, with issues such as climate, human capital management, Diversity, Equity and Inclusion (DEI), supply chain management and biodiversity among top priorities. In the M&A context, the past year has seen growing awareness and recognition among senior executives that ESG issues can impact deal synergies, stakeholder and market reception to announced transactions and the longer-term growth prospects of the combined company. While not yet a driving factor in M&A, ESG's influence on dealmaking will likely continue to grow.

A large portion of recent ESG-influenced dealmaking has been in the energy sector where traditional energy producers have faced demands from investors to reduce their emissions footprint. Certain energy companies have already committed divesting "brown" assets in favor of "green" assets. Last year, PSEG sold its fossil fuel plants to ArcLight Capital as part of its plans to expand investments in nuclear and wind energy. BP, meanwhile, has committed to divesting $25 billion of assets by 2025 to support its strategic pivot towards renewables. The shift to renewables has also created opportunities for companies to acquire assets with lower emission density, as demonstrated by Shell's sale of its Permian Basin assets to ConocoPhillips. Private companies and investors are also recognizing the deal-making opportunities presented by clean energy transition efforts: Thailand's state-owned energy firm PTTEP purchased BP's stake in its Omani gas fields last year.

Activists have capitalized on ESG to drive M&A. In the last quarter of 2021, Elliott Management publicly attacked U.K. utility company SSE's decision not to spin off its renewables business. Activist hedge fund Third Point similarly proposed a separation of Shell's legacy oil and gas business from its newer carbon-light businesses.

With demand for ESG data and analytics continuing to grow, traditional asset managers and data analytics firms have sought to acquire key ESG service providers. The trend began in 2020, with Morningstar's acquisition of Sustainalytics, a leading provider of ESG research and analysis. In 2021, Deutsche Börse completed its acquisition of a majority stake in Institutional Shareholder Services. Deutsche Börse highlighted ISS's ESG capabilities, and framed the acquisition as an effort to "support market participants in making well-informed investment decisions with a particular view on sustainability criteria." Other companies, including Moody's, Blackstone, Nasdaq, JPMorgan, AXA, BlackRock, KKR and McKinsey, all acquired data analytics and/or consulting firms with ESG expertise. In addition, Goldman Sachs acquired NN Investment Partners and Affiliated Managers Group acquired Parnassus, both of which had strong ESG-focused investment offerings.

Given the ongoing focus on ESG ratings, companies with weak ESG performance may buy better-performing companies, or better-performing companies may seek to "clean up" operations at low ESG performers. Given the lack at this time of standardized and verifiable ESG reporting, there is a risk that some of these transactions may be seen as (or may in fact be) little more than greenwashing, making it important to clearly explain the rationale for any such transactions.

ESG as a process driver: valuation, due diligence, contractual innovations, and post-merger integration

Companies will be increasingly expected to follow in the footsteps of investors by integrating ESG considerations into the procedural aspects of dealmaking. Over the past year, ESG has demonstrated its ability to move markets: Royal Dutch Shell and ConocoPhillips both saw their stock prices rise following the announcement of the former's sale of its Permian Basin assets to the latter. A recent McKinsey survey also indicated that executives are willing to pay an "ESG premium" for companies with strong ESG performance.

In addition to assessing ESG risks, such as corrupt business practices, labor law violations, cybersecurity threats and excessive carbon emissions, acquirors will increasingly need to examine related processes and procedures, including the degree of board oversight and the scope and quality of internal and external ESG reporting to detect latent ESG vulnerabilities. Acquirors will also need to make a determination of the *pro forma* ESG impact of a transaction, including the impact on reputation and culture, when assessing deal synergies. On the

target side, boards and management teams will also need to be cognizant that ESG concerns may increasingly factor into shareholder decisions to support or reject a proposed transaction, particularly where the deal consideration includes shares of the acquiror. Integrating ESG into reverse due diligence can help target companies make a stronger case to their shareholders.

In M&A contracts, ESG provisions, while currently rare, may help bridge the gaps between due diligence and ESG-related deal risks. The pandemic saw the introduction of carve-outs for COVID-19 and related measures in MAE clauses and IOCs. ESG issues could make more frequent appearances in sections such as MAE clauses, representations and warranties and IOCs to reflect the growing value investors place on ESG performance and risk management and as ESG controversies continue to grab headlines and regulator attention.

ESG considerations may also shape post-merger governance structures. Integration efforts will need to be sensitive to existing ESG goals, policies and procedures of the combined company, so as not to adversely impact the ESG profile of the combined company.

Creative deal structures for volatile times

The past two years have demonstrated the challenge of striking deals in an environment where unexpected challenges to long-held assumptions – around public health, supply chains, interest rates and much more – have become the norm. Amidst this level of change, deal structures have also evolved to address the new era.

Parties, particularly on the private equity side, have embraced new structures such as joint ventures, minority investments, SPACs (discussed further below), private investments in public equity (PIPEs) and "club" deals with multiple private equity firms. These structures help mitigate risks and spread potential upside across multiple investors or between the buyer and seller. In addition, deals are frequently structured with two or more of these wrinkles. For instance, satellite-imaging company Planet Labs planned an SPAC merger that also included a PIPE with its existing investor, Google, as well as new investors. In such cases, the PIPE investors serve as public validators for the listing's valuation.

As valuations continue to increase, sellers are increasingly seeking equity clawbacks whereby the seller would share in the consideration received by the buyer in a subsequent sale of the asset. Alternatively, contingent consideration or earn-outs have become more accepted options, even beyond deals involving pharmaceutical companies with uncertain product prospects. These newly embraced deal terms reflect a business reality that demands agility and flexibility.

SPACs in the spotlight: questions and doubts

In 2020, SPACs provided a venue for investors seeking splashy above-market returns. These "blank-check" entities became prominent, in part due to the involvement of high-profile investors like Chamath Palihapitiya and Bill Ackman. Investment targets similarly gained attention: funds often flowed to new technologies and untested business models.

In 2021, the bubble deflated significantly. SPACs have faced increasing regulatory scrutiny due to perceived shortfalls in disclosures and broadly inadequate investor protection. The SEC, in particular, has focused on projections as a major source of concern. In the midst of SPACs touting particularly rosy business outlooks, John Coates, then-Acting Director of the Division of Corporation Finance, warned of his fear "that participants may not have thought through all the legal implications of these statements under the circumstances of these transactions." In April, the SEC brought its first SPAC-related enforcement action against a deal involving Momentus, Inc., focusing on inadequate disclosure regarding its technology and associated national security risks. Other enforcement actions charging disclosure gaps and misleading or false statements followed, including against the founder of electric truck company Nikola and music streaming company Akazoo.

Not unexpectedly, private investor litigation has also emerged as SPACs failed to meet investor expectations. A recent Delaware case, *In Re Multiplan Corp.*, provided an opportunity for the court to consider the potential conflicts of interest raised by SPACs and the implications under Delaware fiduciary law. The shareholder complaint filed in the Delaware Court of Chancery alleged that the SPAC sponsors misled shareholders on the prospects of the target company Multiplan and that the SPAC's fiduciaries were unduly influenced by their founder shares, which (as in all SPACs) were purchased for a nominal price and would convert into common shares only if a transaction were completed. After the "de-SPAC" merger, Multiplan lost its primary customer, its shares plummeted and shareholders sued. Vice Chancellor Lori Will rejected the defendants' motion to dismiss, agreeing with the plaintiff's argument that, because of the conflicting interests, the entire fairness standard should apply. The Court focused on two separate analyses: first, the "special benefit" available to the controlling shareholder and SPAC sponsor, who held founder shares converting upon the completion of the transaction; and second, the majority of the board being self-interested (due to the directors' own holding of founder shares) or lacking independence from the founder.

Regulatory attention, growing investor skepticism and, to a lesser degree, litigation activity, have led to a slowdown in SPAC transactions, but still constituted a significant part of M&A activity in 2021. Future years may see more SPAC activity, with evolving disclosure and fiduciary standards providing greater legal protections for investors.

The birth of crypto-M&A

Our last highlighted development from 2021 is the potential impact on M&A from the explosive growth of the cryptocurrency industry, the growing acceptance of cryptocurrencies as a form of exchange in "traditional" corporate America, and the trend towards decentralized protocols (so-called "Web3").

Initially, Silicon Valley eminences like Elon Musk served as the primary CEO boosters of cryptocurrencies. Musk announced in March 2021 that Tesla would work on accepting Bitcoin for car purchases (although he subsequently retracted that idea), and has been the primary driver of a sometimes white-hot Dogecoin market. Michael Saylor of MicroStrategy has been an outspoken advocate of Bitcoin in corporate treasuries, with his company purchasing over $2 billion of Bitcoin during the first three quarters of 2021. And buoyed by the growing importance of Square's cryptocurrency products to the company's bottom line, Jack Dorsey went so far as to rename the company Block. Increasingly, corporate leaders in other sectors have used cryptocurrency as a shibboleth to project tech-savviness. AMC Theaters, the struggling chain and darling of retail investors, has announced plans to accept cryptocurrency as payments. These developments may be indicators that cryptocurrency (including stablecoins with value pegged to underlying dollars or other fiat currency) could gain acceptance as a valid form of payment and become as ubiquitous as contactless card readers and QR codes. In future M&A transactions, dealmakers will face the quandary of conducting due diligence on and valuing such cryptocurrency

assets if companies choose to keep the myriad of currencies on their books, as well as cryptocurrency-related business activities (many of which are still operating in a regulatory fog).

The M&A market has reflected increased optimism for cryptocurrency adoption, with both traditional financial services firms and newer market entrants engaging in strategic transactions to bolster their positions in a rapidly evolving landscape. Notable 2021 transactions included Galaxy Digital's acquisition of BitGo in a $1.2 billion transaction aimed at forming a market leading provider of digital asset financial services for institutional customers, Mastercard's acquisition of CipherTrace, a company providing intelligence and analytics to support anti-money laundering compliance in cryptocurrency transactions, and Robinhood's acquisition of Cove, a platform enabling users to trade on multiple exchanges and manage cryptocurrency holdings. Given the explosive growth and valuations of many cryptocurrency-focused companies, such as Coinbase, and the burgeoning number of unicorns seeking successful exits, acquirors will likely continue to seek opportunities to purchase and bring in-house new capabilities and offerings. The Bitcoin mining industry in the United States may witness consolidation, as the nexus of much mining activity has shifted domestically following the most recent Chinese ban. And as decentralized exchanges, lending platforms and organizational forms arise to challenge traditional financial and business models, novel transaction types are emerging, with 2021 witnessing a protocol merger (effected through software) between Rari Capital and Fei Protocol, two decentralized autonomous organizations controlling billions of dollars in value.

An interesting question is whether cryptocurrency may begin to serve as a viable form of consideration in future M&A transactions. To the extent not involving a *bona fide* stablecoin, such transactions could lean on traditional mechanisms like collars, caps and walk-away rights to deal with consideration of fluctuating value. Depending on the cryptocurrency in question, complex questions of securities law could arise (with the SEC continuing to refrain from expressing a firm position as to the legal treatment of particular cryptocurrencies other than Bitcoin and Ripple, with the former a non-security and the latter a security in the SEC's view). Alternatively, deals could remain denominated in U.S. dollars, with an exchange rate to a cryptocurrency to be defined at or shortly before closing.

Conclusion

The past year has provided much fodder for M&A prognosticators, as investor expectations, regulatory action and technological changes continued to influence dealmaking. In 2022, many of these trends will be tested by emerging concerns, such as the duration of higher-than-normal inflation, the expected withdrawal of fiscal and monetary support, and ongoing labor market and supply chain issues. Despite these headwinds, current indications point to continued strong deal flows in 2022.

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Adam O. Emmerich focuses primarily on M&A, Corporate Governance and securities law matters. His practice has included a broad and varied representation of public and private enterprises in a variety of industries throughout the United States, and globally in connection with M&A, divestitures, spin-offs, joint ventures, and financing transactions. He also has extensive experience in takeover defense and corporate governance issues. Adam is recognized as: one of the world's leading lawyers in the field of M&A by *Chambers and Partners*; an expert in M&A, Corporate Governance and M&A in the real estate field by *Who's Who Legal*; among the Best of the Best USA by *Euromoney Institutional Investor's Expert Guides*, including as an expert in M&A and Corporate Governance; and one of *LawDragon*'s 500 Leading Lawyers in America. Adam was also named one of Hollywood's Top 20 Dealmakers by *The Hollywood Reporter*.

Wachtell, Lipton, Rosen & Katz
51 West 52nd Street
New York, NY 10019
USA

Tel: +1 212 403 1234
Fax: +1 212 403 2234
Email: AOEmmerich@wlrk.com
URL: www.wlrk.com

Trevor S. Norwitz focuses primarily on M&A, corporate governance and securities law matters. He has advised a range of public and private entities in a variety of industries in connection with mergers, acquisitions, divestitures, hostile takeover bids and defenses, proxy contests, joint ventures, financing transactions and corporate governance matters. In addition to his professional practice, Trevor teaches a course in M&A at Columbia Law School, chaired the New York City Bar M&A Committee and is active on several other bar committees, and was a member of an international advisory group to the South African government on company law reform. He is a regular speaker and contributor to professional publications on topics relating to M&A and corporate governance, areas in which his expertise is recognized by *Who's Who Legal* and *Chambers*. Trevor was also named an *American Lawyer* Dealmaker of the Year. He holds law degrees from the University of Oxford and Columbia Law School.

Wachtell, Lipton, Rosen & Katz
51 West 52nd Street
New York, NY 10019
USA

Tel: +1 212 403 1333
Fax: +1 212 403 2333
Email: TSNorwitz@wlrk.com
URL: www.wlrk.com

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