Global M&A

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After a strong start in the first half of 2011, deal activity during the second half of the year was restrained by continued uncertainty about the strength of the global economic recovery, market volatility, sovereign debt issues in Europe, regulatory and political questions worldwide, and other global events. While these issues continue to affect the M&A landscape, we believe that the predicates exist for a strengthening of the M&A market in 2012.

U.S.: Strategic M&A, Spin-Offs, Hostile Transactions and Private Equity

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Strategic M&A Continues to Drive Overall Deal Activity

The dollar value of announced M&A transactions involving U.S. targets rose by approximately 12 percent during 2011 compared with 2010, according to Dealogic data. However, the total number of announced transactions remained relatively flat, with activity levels at their highest in the first quarter of 2011 and slowing during the rest of the year amid increasing economic uncertainty and market volatility.

Strategic M&A was the primary driver of overall activity last year, with an increase in larger, billion-dollar-plus transactions compared to 2010. Strategic buyers — in particular, well-established investment grade companies that have substantial amounts of cash on their balance sheets, improving outlooks on future business performance and access to financing on favorable terms — looked to M&A as a way to generate growth faster than could be achieved organically in the current economic environment. Industry sectors that were particularly active in 2011 M&A transactions included pharmaceuticals/health care, energy/oil & gas, telecommunications/technology, real estate, chemicals and financial services. Given the liquidity available to strategic buyers, we expect cash to continue to be the preferred form of consideration in acquisitions, although equity and mixed consideration will continue to be used in transformative combinations (including mergers of equals), transactions where the buyer faces leverage constraints and those in which the seller is unwilling to give up the opportunity to participate in the potential future upside of the combined company.

However, in light of ongoing uncertainty in the economic environment, both buyers and sellers have exhibited caution in approaching M&A transactions. Boards and CEOs of potential buyers continue to be wary of potential adverse investor reaction to major acquisitions during a time of uncertainty. Moreover, some sellers have been reluctant to sell in the current environment and consider it more desirable to do so only after economic conditions have stabilized and market valuations have improved.

Spin-Offs as a Value-Enhancing Divestiture Alternative

In recent years, companies considering the divestiture of a business increasingly have looked to spin-offs as an attractive alternative to a traditional business unit or divisional sale in light of the deal execution challenges presented in the current environment. Recently announced examples include Abbott Laboratories' spin-off of its research-based pharmaceuticals business, Fortune Brands' spin-off of its home and security business, Kraft Foods' spin-off of its North American grocery unit, McGraw-Hill's spin-off of its education business, Sara Lee's spin-off of its international coffee and tea business, and the split of each of Tyco International and ITT into three companies, substantially completing the disassembling of two of the remaining major conglomerates. Particularly among larger companies, spin-off transactions are viewed as a means to unlock value for shareholders on a tax-free basis by separating divergent businesses, providing each separated business with greater focus on its own growth prospects and strategies, and better aligning management's interests with the applicable business. Additionally, spin-offs may position the separated businesses as more attractive acquisition

candidates, thereby creating additional potential benefits for shareholders. Further, subject to applicable tax limitations, it is possible to realize cash proceeds in connection with a spin-off — by conducting an initial public offering of a portion of the spun-off company prior to its full separation, placing debt on the spun-off company's capital structure prior to its separation or engaging in other monetization strategies. In light of the various benefits, spin-offs generally have been well received by investors looking to improve near-term returns. Indeed, a number of hedge fund activists recently have called for certain public companies to consider spin-off transactions to enhance value.

> "In light of the various benefits, spin-offs generally have been well received by investors looking to improve near-term returns."

Some companies considering divestiture of a business have opted for a dual-track approach of pursuing a sale of the business to be separated while simultaneously preparing for a potential spin-off or IPO of that business. A dual-track process can ensure that the seller will have a path to separate the business if a sale is not successful and may provide the seller with negotiating leverage if a sale process only attracts limited interest among potential bidders.

Companies contemplating a spin-off should be aware that the documentation and implementation process can be complex, requiring significant advance preparation. Key issues to be addressed in a spin-off context include, among others:

- Defining the scope of the businesses, assets and liabilities (including any "shared" assets and liabilities) to be separated, while ensuring that the company to be spun off will be able to operate as a viable, independent company post-separation;
- Determining any commercial, indemnification and other arrangements expected to continue between the separated businesses post-spin;
- Determining the appropriate capital structure for the spun-off company;
- Determining the governance (including board composition) and structural takeover protections of the spun-off company; and
- Addressing employee- and management-related issues for the spun-off company.

Significant tax work, including planning for the internal reorganization steps necessary to separate the spun-off company and obtaining private letter rulings from the Internal Revenue Service, also typically is required to ensure that the spin-off and any related monetization strategies are properly effected on a tax-free basis.

Increase in Hostile Transactions/Multiparty Bidding Wars

Hostile or unsolicited transactions have increased significantly over the past two years and are likely to be prominent in 2012. These transactions have included all-cash offers as well as stock or mixed-consideration offers. Strategic buyers with significant cash reserves and available financing have continued to make unsolicited bids and pursue hostile tactics in order to seize upon growth opportunities not otherwise available and push for a sale even when the target is not otherwise a willing seller. Given recent market volatility, the trading prices of many

public companies are still well below their 52-week highs, and target trading multiples and valuations remain attractive to potential buyers. Target companies with significant cash balances and weakened structural takeover defenses could find themselves particularly vulnerable to an unsolicited approach in the current environment as potential strategic buyers gain more confidence. Even financial buyers, which have not traditionally been known to make hostile bids for companies, have entered the fray (*e.g.*, Oaktree Capital Management's unsolicited bid for JAKKS Pacific). In addition, a number of target companies have faced increasing shareholder activism relating to extraordinary transactions or corporate governance "wedge issues" (*e.g.*, say-on-pay, votes on golden parachutes and proxy fights for board representation) or even bids made by an activist to acquire a company with the intent of putting the company "in play" (*e.g.*, Carl Icahn's activities at Clorox, Commercial Metals Co. and Mentor Graphics), which could add to target company vulnerability. (See "Governance/U.S. Corporate Governance Challenges: Say-on-Pay, Proxy Access, Dodd-Frank and Potentially More Auditor Independence Rules.")

As we have commented previously,[1] companies contemplating a hostile or unsolicited strategy should be aware of the inherent challenges to completing such a hostile transaction and an increase in the rate of successful defenses made against such offers in recent years. In addition, the Delaware Court of Chancery's *Airgas* decision confirms the latitude a target board has in opposing an unsolicted offer. (See "Global M&A/The Impact of Recent Delaware Decisions and Multiforum Litigation on M&A/Delaware Cases.") As a result, the success rate of hostile offers has been mixed, with most not succeeding and the target company either managing to stay independent (*e.g.*, ConAgra Foods' withdrawn offer for Ralcorp Holdings) or ending up being acquired by another party (*e.g.*, Cephalon's acquisition by Teva Pharmaceuticals after receiving an unsolicited bid from Valeant Pharmaceuticals).

The practice of third parties bidding to acquire companies that already have announced transactions also has been prominent (*e.g.*, the bids from Validus Holdings and Berkshire Hathaway for Transatlantic Holdings following its announced deal with Allied World Assurance, the successive bids by Hertz and Avis-Budget Group for Dollar Thrifty, and the bid by Nasdaq OMX and IntercontinentalExchange to acquire the New York Stock Exchange following its earlier agreement to merge with Deutsche Börse). As deals are announced at valuations that are, from a buyer's perspective, relatively attractive in the current market, we anticipate a continuation of the practice of "deal jumping."

Private Equity Firms Remain Active Amid Difficult Markets

Private equity investment activity in the U.S. declined slightly in 2011 compared to 2010 and, while an improvement over 2009, has remained well below the levels seen prior to the financial crisis. While some market observers had predicted higher levels of private equity buyout activity based on the significant amounts of "dry powder," or callable capital reserves, of the private equity funds, continued

[1] *See* Skadden *Insights*, "Mid-Year Outlook: Continued Corporate Focus on Strategic Growth Drives M&A Market" (June 21, 2011), *available at* http://www.skadden.com/Index.cfm?contentID=51&itemID=2453.

economic uncertainty and volatile market conditions for the leveraged loans and high-yield bonds that typically finance private equity buyout transactions have made deals more difficult to get done on attractive terms. Factors that also may be contributing to this restrained level of activity include, among others, bank requirements that greater percentages of deal consideration include equity financing provided by the private equity funds and increased competition in bidding for attractive targets. As a result, the deals that have been completed are generally smaller acquisitions with less leverage than those prior to the financial crisis. In addition, we have seen an increase in "add-on" acquisitions by private equity firms involving businesses that are complementary to existing portfolio companies. We believe that private equity firms will continue to put their capital to work in new investments in 2012, but likely will be subject to the same factors currently impacting these investments.

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In addition, private equity firms continue to review alternatives for their existing portfolio companies — including restructurings, recapitalizations and divestitures — in an environment where public market exit alternatives have been more difficult to implement successfully, and portfolio companies with high levels of leverage and slowly recovering financial performance may not be positioned optimally for a public exit or sale. Complicating matters for private equity firms is the fact that many continue to face end-of-fund-life issues, which have arisen with greater frequency as the private equity industry matures and more funds are reaching their contractually mandated duration. Funds with these end-of-life issues often have the difficult task of convincing buyers to eliminate or curtail future obligations of the private equity sellers, including indemnification and post-closing covenants, in order to allow the funds to liquidate and make final distributions to their investors. We expect these issues to continue in 2012.

Continued Focus on Key Deal Terms

Buyers and sellers in strategic and private equity transactions continue to focus on provisions affecting deal certainty, with a particular emphasis on provisions relating to the buyer's financing of the transaction and the seller's recourse in the event that financing is not available. In strategic transactions, while there have been some exceptions, the majority of deals continue to employ the traditional model of specific performance and full recourse against the buyer if it fails to close when closing conditions are satisfied. Sellers also have focused on the material adverse effect condition and definition to have greater assurance that the buyer cannot avoid its obligations to close on that basis, given the uncertainty in the current environment.

In private equity acquisitions, we have seen several variations of reverse termination fee constructs in agreements, with the trend toward the stricter of the variations. During the prior cycle, private equity buyers had benefited from the "pure option" model, which would permit them to pay a reverse termination fee (typically 3-4 percent) as the sole remedy if they failed to close for any reason. A number of recent transactions have employed a more stringent model that applies the reverse termination fee remedy structure only if the buyer's debt financing is unavailable notwithstanding the buyer's efforts; otherwise, the seller would have the ability to

require the buyer to draw upon its financing and close the transaction. In other transactions, we have seen bifurcated reverse termination fees, where a higher fee is payable if the buyer's financing is available but the buyer does not close. Sellers also have been focused on narrowing "marketing period" provisions that would give the buyer the right to delay closing for a specified period of time after being provided information about the target for use in its financing materials.

The recently increased level of antitrust enforcement activities by the government (see "Global M&A/Global Antitrust Enforcement in M&A Transactions") has resulted in buyers and sellers spending more time negotiating regulatory provisions in acquisition agreements in order to achieve the appropriate balance of risk sharing between the parties. While sellers have an interest in ensuring deal certainty, buyers have an interest in ensuring that regulatory divestiture obligations do not have a material impact on the expected benefits of the transaction. Increasingly, parties are paying greater attention to defining specific efforts required to obtain the necessary regulatory approvals, including the extent to which the buyer will have an explicit obligation to divest or hold separate assets (and what, if any, limitations are put on such obligations), litigate against the government or make other commitments to obtain the required approvals. Defining these efforts can be particularly challenging when vertical antitrust issues are involved. The remedies available to the seller if such efforts are not successful also has been a highly negotiated issue. While there have been some recently announced deals with substantial reverse termination fees for failure to obtain regulatory approvals (*e.g.*, AT&T's agreement to pay Deutsche Telekom a fee of $3 billion in cash and provide wireless spectrum with a book value of $1 billion, as well as certain roaming rights — which recently was terminated and the fee paid — and Google's agreement to pay Motorola Mobility $2.5 billion), these continue to be the exception, and some recent agreements have had either no fee or a more modest fee.

Deal protection also remains a key issue in negotiations, as buyers seek greater certainty that their deal will close once announced. Fiduciary out provisions, including "intervening event" provisions that enable a target to change its recommendation of the deal in certain circumstances outside of a superior proposal context, and the breakup fees payable in such circumstances, remain topics of negotiation. In addition, we continue to see requests by some public company targets that have not conducted a presigning auction or market check for go-shop provisions which permit the target actively to solicit other bids for a specified period of time following signing (typically 30-45 days) and provide for a lower breakup fee if a higher offer is made during the go-shop period. Go-shop provisions are far more typical in agreements involving private equity buyers but have surfaced in some discussions involving strategic buyers. Strategic buyers frequently have rejected such requests, as they are unwilling to permit target management to shop their deal to third parties and proactively share sensitive, confidential information with third parties (including competitors) that may or may not surface with a higher bid for the target. Targets that are able to obtain a go-shop provision may feel compelled to go through a full sale process or risk being criticized if they do not do so. As a compromise, some strategic buyers have agreed to a hybrid provision in

which the breakup fee for an unsolicited superior proposal would be reduced during a specified period of time after signing, but the target would not be permitted to proactively solicit competing bids.

European Union: The UK-Continental Europe Debate on Takeover Regulation

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The Great Debate

The UK has the most mature and active market for corporate control in Europe. This is in large part due to the fact that the number and size of companies which have primary listings in London dwarf (and historically has dwarfed) that of any other exchange in Europe. It is therefore not surprising that European takeover principles embodied in the EU Takeovers Directive are founded upon the basic principles that have underpinned the regulation of more than 9,000 bids in the UK since 1968, and that European regulators have looked to London when formulating and applying their own bid rules adopted to implement the EU Takeovers Directive. Therefore, changes to the UK Takeover Code (the UK Code) usually have ripple effects across continental Europe.

September 19, 2011, was the day the UK M&A market finally ended the introspection occasioned by the Cadbury/Kraft transaction and began to adjust to a number of amendments to the UK Code designed to redress the perceived tactical imbalance favoring bidders. Europe, in the meantime, continued to consider a number of regulatory initiatives, driven by an economic and political storm engulfing much of Europe that is shaking the very foundations of the European Union itself.

As eurozone politicians are attempting to avert a financial and credit crunch that could break up the euro and, as a result, set European convergence back by decades, the UK is concerned with maintaining control over the regulatory framework that has made London the financial heart of Europe and one of the principal financial centers worldwide.

These powerful dynamics now drive a debate on legal and regulatory issues, the outcome of which (possibly in 2012) likely will give direction to Europe's regulatory development — including with respect to M&A — for many years to come.

2011: The Cadbury Catharsis — Important Changes to the UK Takeover Landscape

On September 19, 2011, after 18 months of debate triggered by Kraft's bid for Cadbury, the much-anticipated amendments to the UK Code, designed to redress the perceived tactical imbalance favoring bidders, came into effect. Those changes, which will be reviewed following their first year of operation, included:[2]

[2] For a more detailed discussion of the UK Code amendments, see Skadden's *Insights* discussions on "UK Takeover Code — Changes Effective September 19, 2011" (Sept. 21, 2011), *available at* http://skadden.com/newsletters/UK_Takeover_Code_Changes_Effective_September_19_2011.pdf; and "Backing the Target Board: Proposed Changes to Rebalance UK Takeover" (June 21, 2011), *available at* http://skadden.com/newsletters/Backing_the_Target_Board_Proposed_Changes_to_Rebalance_UK_Takeover.pdf.

- Identifying, except in limited circumstances, potential bidders in target announcements initiating offer periods and setting a default 28-day bid deadline;
- Banning, except in limited circumstances, deal protections, thus eliminating a number of contractual protections familiar to bidders, such as breakup fees, as well as information and matching rights;
- Displaying financing documents in unredacted form when a firm offer announcement is made (as opposed to when an offer document is posted, up to 28 days later) and requiring a more detailed description of the financing arrangements in the offer document (see "Capital Markets/Potential Implications of the UK's Enhanced Disclosure Requirements on Debt Financing of Takeover Bids");
- Requiring bidders and targets to disclose an aggregate estimate of advisors' fees by category, and obligating the bidder to disclose an estimate of financing fees;
- Forcing cash bidders to disclose the same financial information as paper bidders;
- Obligating bidders to provide statements of intention regarding the target (or confirm the absence of such intentions) and adhere to all such statements (positive or negative) for a period of 12 months; and
- Proposing a number of changes to strengthen the ability of employee representatives to provide their opinion on the deal.

UK market practice already is responding to these changes to the regulatory landscape. As a principles-based system, it will be important to see how the UK Takeover Panel (the Panel) applies the new rules to particular deals. Only then will we know whether the intended shift in the balance of power away from hostile bidders and toward target boards is an effective and proportionate response to concerns raised following Kraft's bid for Cadbury, or whether the changes have gone too far and inhibit deal activity in the United Kingdom.

Two trends are discernible based on the limited data points since the changes took effect. The first is that a significant number of bids are being extended beyond the initial 28-day period, often on more than one occasion, but always by an additional 28-day period. Bidders that engage with the target board therefore are able to relieve the up-front timing pressure. Indeed, in one case a bidder has agreed to pay a reverse breakup fee if it does not make a bid by the end of March 2012, and the target has publicly announced its intention to seek extensions to the 28-day deadline. We expect that the obligation to pay that reverse breakup fee is conditioned upon such extensions being agreed upon, which, because it does not create an obligation on the target, should not amount to a banned contractual deal protection. In effect, the UK Code has been used as a proxy for the contractual undertaking the target may have given previously, since the Panel will expect the target to be bound by its own public statements.

Second, a significant number of targets that announce formal sales processes are in severe financial difficulty; and, notwithstanding that the target could have agreed to a breakup fee and possibly other deal protections to the successful participant in the process (because, as an exception to the general rule, certain deal protection measures are allowed if they apply to the prevailing bid in a formal

auction process), this does not appear to be happening. Instead, a number of these companies are being put into administration, and their assets and businesses are being sold by the administrator in so-called "prepack" deals.

UK Code as Forerunner — The Dutch Example

The UK Code principles, which were adopted by the EU Takeovers Directive, have in large part shaped regulation of public M&A in Europe, and European regulators continue to look to London when formulating and applying their own bid rules. The Netherlands, for example, has proposed to make amendments to the Dutch Act on Financial Supervision and the Dutch Takeover Decree (collectively, the Dutch Bid Rules), some of which reflect the UK Code prior to the most recent changes.

Among the changes to the Dutch Bid Rules, a "put-up-or-shut-up" (PUSU) rule is being proposed, modelled on the UK Code rule first publicly articulated by the Panel in 1991. Even before then, the Panel allowed a target to request the Panel to set a date (usually six weeks hence) by which a possible bidder must either bid or walk away, in order to give effect to the general principle that target companies should not be subjected to an unnecessarily long period of siege and uncertainty. If the Dutch Bid Rules are implemented as currently proposed, Dutch targets will be able to request that the Dutch Authority for Financial Markets (AFM) set a PUSU deadline mandating a bid or no-intention-to-bid statement within six weeks.

> "European regulators continue to look to London when formulating and applying their own bid rules."

Time will tell whether at some point in the future the AFM will reach the conclusion, as the Panel did, that it is a "difficult and contentious" decision for a target board to request a PUSU deadline, and as a result, a 28-day deadline should apply as a default from the public identification of a possible bidder. Similarly, it would not be surprising if other member states were to consider bringing in their own PUSU rule.

Continental European Trends

In April 2004, the EU Takeovers Directive was adopted as one of the key items of the EU Financial Services Action Plan. Approval by the member states was only achieved following rejection by the European Parliament of previous versions of the EU Takeovers Directive (for various reasons, including that it failed to level the playing field with U.S. companies) and the application of the "reciprocity" principle (the "Portuguese compromise") to the board neutrality and breakthrough rules, which broadly prohibit a target from taking frustrating action before or during a bid. The EU Takeovers Directive was controversial at the time it was adopted, and therefore member states included an "escape hatch" in the form of a five-year review requirement.

However, the EU Takeovers Directive's principles now have become a cornerstone of public M&A in continental Europe and are there to stay. A new European regulator has been created — the European Securities Market Association (ESMA) — with ostensible authority over the EU Takeovers Directive. Review of the EU Takeovers Directive currently is under way, and it is not possible to predict what changes may be contemplated. However, it seems that the basic structure and compromises agreed upon in 2004, are unlikely to be changed significantly. That

said, it will be interesting to see how much, if any, of the recent changes to the UK Code will be considered in the review of the EU Takeovers Directive (in particular, those that were based on European concepts).

The EU Takeovers Directive should not be seen in isolation, but rather as a harbinger of change in the broader sphere of European company law and a significant step toward regulatory conversion. In this regard, the proliferation of EU corporate law since the adoption of the EU Takeovers Directive and the number of current proposals for new laws must be considered. A discussion of all current proposals is beyond the scope of this article, but these include:

- **The EU Green Paper on Corporate Governance.** Corporate governance underpins takeover regulation, and the development of this debate, spurred by the perceived failings of financial institutions in the most recent crisis, will be important.
- **Proposed Amendments to the Transparency Directive.** Some proposals, such as those requiring disclosure of certain cash-settled derivatives in the target's stock, may be welcomed; they essentially catch up with UK requirements that have applied since 2006 and the German requirements that will be in force from February 1, 2012. However, the "maximum harmonization" approach taken to the notification of interests in voting shares, which would limit the ability of member states to impose more onerous requirements than those set out in the EU Takeovers Directive ("gold-plating"), would not be welcomed, as they would reduce the amount of information required to be disclosed outside a bid situation in the UK and reduce the quality of disclosure during the course of a bid regulated by the UK Code.
- **Short Selling — ESMA Review.** European regulators and politicians seem to believe they are facing a single combatant called "The Bond Market," rather than a multitude of individuals making trading decisions on the basis of credit analyses. This was seen in the actions of ESMA in August when it coordinated discussions among various EU member states that resulted in the extension or creation of short-selling bans in various countries. In November, ESMA said that "EU securities regulators are closely monitoring the functioning of the markets and continue considering possible actions which might be taken to contribute to the orderly functioning of markets." The extent to which the EU seeks to regulate the financial markets is of great concern to the UK, and it would not be surprising if the UK government continues to put a brake on certain European initiatives in this area in exchange for its acquiescence to or support for treaty changes or the use of EU institutions to support the single currency. An alternative scenario would be the formation of a group of European countries that agrees to introduce more stringent regulation of their respective financial markets, which could include a transaction tax on securities trades.

European Currency

If the European project is able to weather the storm, we expect to see a continued, and accelerated, expansion of EU law and regulation designed to drive European integration toward a single market. This likely will have a significant

effect on mergers and acquisitions, as well corporate law more generally, and financial regulation in EU member states. An important determinant of the shape of that structure will be the role the UK plays in its development, and the extent to which UK ideas and perspectives maintain their currency in the eyes of continental European constituencies. (See "Capital Markets/The Effect of a Eurozone Breakup on Euro-Denominated Corporate Bonds and Loans.")

High-Growth Markets: An Attractive Inbound and Outbound M&A Option

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M&A activity in the high-growth markets in 2011 accounted for a total value of approximately $667.4 billion (a 13.6 percent decrease compared to 2010), which represented 26 percent of global M&A activity (compared to 17 percent for 2010), according to Thomson Reuters. Following a robust first half, high-growth market M&A activity slowed during the second half of 2011, with a dramatic drop-off in the fourth quarter, partially as a result of the global impact of the European debt crisis. China led all high-growth nations as the most targeted high-growth market in terms of both deal volume and deal value (accounting for 3,689 total deals worth a combined $140.9 billion, according to Thomson Reuters), followed by Brazil, Russia, Mexico, India, Chile and Malaysia. Dealmaking in these markets was strongest in the energy and power sector (which represented 21.3 percent of high-growth market volumes, with $141.9 billion in deal activity, according to Thomson Reuters), followed by the materials ($136.4 billion), financial and industrial sectors.

Although high-growth market M&A activity failed to sustain the spectacular growth it experienced in 2010, these markets remain attractive options for companies from both developed and high-growth markets looking to do deals. As Europe continues to struggle with the sovereign debt crisis and currency depreciation, presidential campaigning ramps up in the United States and managers seek to meet or exceed ambitious growth targets in the coming year, we believe that the pace of M&A activity in high-growth markets will accelerate in 2012. Additionally, the looming threat of a double-dip recession in developed economies and a growing scarcity of high-quality M&A targets in high-growth market countries could push managers to swiftly seize M&A opportunities in high-growth markets in the near term.

Consistent with recent years, private equity and sovereign wealth funds, flush with cash, should lead inbound M&A in high-growth markets. Growth-stage companies without access to the capital markets will look to these funds for needed financing. Beyond the BRIC countries, private equity and institutional investors also are seeking opportunities in other markets with high-growth rates, robust balance sheets and relatively large populations that remain underserved, including Latin America ex-Brazil, Indonesia, Vietnam, South Africa and South Korea.

In addition, many of the multinationals with strong cash positions (particularly from the U.S.) and limited growth opportunities in their main markets (U.S. and Europe) may establish or increase their footholds in high-growth markets through acquisitions in 2012. We see this particularly likely in the retail and consumer products (including food and beverage) and the health care and pharmaceuticals sectors.

We also expect continuing outbound M&A from high-growth markets. There has been a dramatic shift from inbound investment into high-growth markets to outbound investment, particularly from the BRIC nations. As an example of this trend, 2011 concluded with China Three Gorges' winning its bid for a $3.5 billion stake in Energias de Portugal S.A. from Parpublica. The bid by Three Gorges, which is China's largest clean energy conglomerate, is the largest-ever Chinese investment in Europe. In other notable matters last year, China's largest oil producer, Sinopec, agreed to pay $2.1 billion for Canadian oil and gas company Daylight Energy, and China's Sichuan Hanlong Group offered $1.3 billion for Australian iron-ore company Sundance Resources. In addition, we also expect to see more capital flows from one high-growth market to another in the near future. For example, in November 2011, Ternium, Latin America's second-largest steelmaker, announced it would pay $2.2 billion to buy a stake in Brazilian rival Usiminas, and the Industrial & Commercial Bank of China agreed to acquire an 80 percent interest in Buenos Aires-based Standard Bank Argentina SA for $600 million.

We also have seen a recent increase in the number of going-private transactions by Chinese companies listed on U.S. exchanges — a trend that is likely to continue in 2012. For a discussion of these transactions, see "Global M&A/China's Coming Wave of Going-Private Transactions."

Africa

In 2011, interest in the continent of Africa continued to increase. According to *The Economist*, total direct investment was greater than $55 billion and private equity firms raised $1.5 billion for deals on the continent in 2010. Current indications are that similar or greater investment and fund raising activity occurred in 2011.[3] Trade between the African continent and the rest of the world has increased approximately 200 percent over the past decade. Continuing the trend of capital flows from high-growth to high-growth markets, Brazil, Russia, India and China account for 20 percent of trade with Africa. Between 2001 and 2010, Africa had six of the world's 10 fastest-growing economies. The IMF is predicting a 5.75 percent growth rate for economies in Sub-Saharan Africa in 2012, and some individual economies are expected to grow at rates of around 10 percent during the same period. Such growth looks even more inviting to investors in the absence of significant prospects in the U.S. and European economies.

However, Africa does not represent a monolithic opportunity. Each of its 55 countries has individualized risks and potential rewards for investors. We anticipate transactions in 2012 will continue to demonstrate the interest of investors in African commodities, such as minerals and oil. We predict the larger transactions in these sectors will involve consolidations and asset sales based on investors' perceptions of global supply and demand for the underlying commodities. One such example is Vitol Group and Helios Investment Partners' $1 billion acquisition of an 80 percent stake in the African downstream oil operations of Royal Dutch

[3] Private equity firms have raised $1.6 billion in funds as of November 15, 2011, according to *Private Equity Africa*.

Shell — a transaction involving at least 14 African country jurisdictions. We also envision large-scale transactions involving infrastructure and energy expansion to support the growing demands of the continent.

The consumer products sector also may experience growing investor activity. Africa is home to more than 1 billion people. The World Bank predicts the continent's middle class will increase in number by 67 percent over the next four years. There already have been notable transactions seeking to capitalize on this trend. In 2011, Wal-Mart Stores, Inc. acquired a 51 percent stake in Massmart Holdings Limited for $2.4 billion. However, while sizable consumer-oriented deals may occur, we anticipate most foreign investors in the near term will continue to engage in midsized transactions in the consumer products sector.

Finally, African countries' youthful populations have proven to be early adopters of technology when given access. For example, the continent of Africa has more than 600 million cell phone users — more than Europe or the United States. We anticipate notable transactions in the telecom space. As an example, in 2011, ZTE Corporation, China's largest listed telecom company, sold its shares in Congo Chine Telecom to a subsidiary of France Telecom. We expect consolidation in the telecom space across the continent to occur on a regional level. We also predict that Africa will continue to be a productive test market for mobile technology products and services, similar to the development in Africa of mobile phone consumer banking in recent years.

The Impact of Recent Delaware Decisions and Multiforum Litigation on M&A

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Delaware Cases

The past year of M&A litigation in Delaware resulted in developments with important implications for companies and financial institutions seeking to engage in M&A transactions.

***Del Monte* and Financial Advisor Conflict Claims.** Several Court of Chancery opinions emphasize the court's concern with potential conflicts of interest involving financial advisors. Most prominently, perceived conflicts involving the advisor to Del Monte Foods led to an injunction and, ultimately, an eight-figure settlement.

On November 24, 2010, Del Monte Foods announced that it had agreed to be acquired by a consortium of private equity firms for $19 per share in cash. Several stockholders sued, seeking to enjoin the deal, and obtained discovery that the Court of Chancery found "disturbed the patina of normalcy" of the transaction. Specifically, the court found (on a preliminary record) that Del Monte's financial advisor had "secretly and selfishly" manipulated the sale process to engineer a transaction that would permit it to obtain lucrative buy-side financing fees. The court concluded that the plaintiffs' findings on the preliminary record presented a reasonable probability of success on the merits of a claim for breach of fiduciary duty against the individual defendants, aided and abetted by the buyer. As a remedy, the court enjoined the stockholder vote on the merger for a period of 20 days and directed that the no-solicitation, matching rights and termination fee provisions of the

> "[R]ecent rulings confirm the [Court of Chancery's] concern with potential financial advisor conflicts and the importance of full disclosure."

merger agreement could be enforced during this period. (No new bidder emerged.) The parties later agreed to settle the claims for approximately $90 million. (See "Capital Markets/Stapled Financing in the Aftermath of Delaware's *Del Monte* Decision.")

Other recent rulings confirm the court's concern with potential financial advisor conflicts and the importance of full disclosure. In *In re Art Technology Group, Inc. Shareholders Litigation*, the court delayed a stockholders' meeting pending disclosure of the compensation paid by the buyer to the target's financial advisor over the prior four years. In *In re Ness Technologies, Inc. Shareholders Litigation*, the court denied a stockholder plaintiff expedited discovery on all claims except one: that the target was obliged to disclose the compensation the target's financial advisors had earned from the buyer in recent years. The court said that if the amount of business was material, "then the failure to disclose fully the extent of that business could violate the duty of disclosure." The Court of Chancery also issued a preliminary injunction in *In re Atheros Communications, Inc.* because of a failure to disclose the incentive the target's financial advisor had to close the pending merger. The court held that the failure to disclose that 98 percent of the target financial advisor's fee was contingent on closing violated the duty of disclosure because "[s]tockholders should know that their financial advisor … stands to reap a large reward only if the transaction closes … ."

***Airgas:* Poison Pill Upheld by Court of Chancery.** The flurry of opinions in 2010 addressing shareholder rights plans ("poison pills") culminated last year in the Court of Chancery's long-awaited post-trial decision in *Air Products & Chemicals, Inc. v. Airgas, Inc.* This opinion is a must-read for any practitioner counseling a board in response to a takeover threat.

In *Airgas*, the Court of Chancery upheld the sustained use of a poison pill to defend against a hostile takeover proposal. The court asked rhetorically,

> Can a board of directors, acting in good faith and with a reasonable factual basis for its decision, when faced with a structurally non-coercive, all-cash, fully financed tender offer directed to the stockholders of the corporation, keep a poison pill in place so as to prevent the stockholders from making their own decision about whether they want to tender their shares — even after the incumbent board has lost one election contest, a full year has gone by since the offer was first made public, and the stockholders are fully informed as to the target board's views on the inadequacy of the offer? If so, does that effectively mean that a board can 'just say never' to a hostile tender offer?

The court addressed those questions, stating that although "a board cannot 'just say no' to a tender offer," the Airgas board had met its legal burden to articulate a legally cognizable threat (the allegedly inadequate price of Air Products' offer, coupled with the fact that a majority of Airgas's stockholders would likely tender into that inadequate offer) and had taken defensive measures that fell within a range of reasonable responses proportionate to the threat. The *Airgas* decision confirms that a board of directors has wide latitude to oppose a hostile takeover

through the use of a poison pill but must convince the court that its actions were both reasonable and proportional.

***OPENLANE:* Rethinking *Omnicare*.** In its opinion in *In re OPENLANE, Inc. Shareholders Litigation*, the Court of Chancery provided important guidance to avoid the risks presented by the Delaware Supreme Court's Opinion in *Omnicare, Inc. v. NCS Healthcare, Inc.* Specifically, the Court of Chancery upheld the practice of obtaining stockholder approval of a merger immediately after board approval, through the use of written consents.

The underlying circumstances involved in *OPENLANE* were unusual and perhaps unique, in that the target board's process and the terms of the transaction have many of the hallmarks of a private company acquisition, yet shortly before execution of the merger agreement the target discovered that it had more than 500 stockholders of record of a series of its preferred stock and therefore should have been filing periodic reports with the SEC. A stockholder alleged that the deal was improperly "locked up" because holders of a majority of the stock submitted written consents approving the merger a day after the merger agreement was executed.

Distinguishing this case from the Delaware Supreme Court's opinion in *Omnicare*, the court held that the merger before it was not a *fait accompli*. In particular, the controlling stockholders had not entered into a voting agreement promising to vote for the merger, as was the case in *Omnicare*; rather, the record "merely suggest[ed] that, after the board approved the merger agreement, the holders of a majority of shares quickly provided consents."

The opinion also is notable for its reliance on a board's "impeccable knowledge" of the company to satisfy its duty under *Revlon*, even in the absence of "any [other] traditional value maximization tool."

Increase in Deal Litigation, Including in Non-Delaware Forums

Over the course of the last year, along with the uptick in deal activity, we have seen an increase in the proportion of deals attracting lawsuits and in the proportion of deal lawsuits filed outside Delaware. The Court of Chancery has noted the increasing practice of the plaintiffs' bar filing claims arising under Delaware law not only in Delaware, but also in a non-Delaware forum. Indeed, Vice Chancellor J. Travis Laster recently noted that "these types of situations now come up several times a month."

In response, the Court of Chancery has sought to make clear that Delaware courts are the proper forum for actions involving Delaware corporate law. For example, in *In re Clarient, Inc. Shareholders Litigation*, Chancellor Leo E. Strine Jr. referred to the "comity among sister states" in advocating that other states should "stay … within your lane" and defer to Delaware courts when Delaware law controls. Similarly, while admitting that other judges are certainly smart enough and capable enough to apply Delaware law, Vice Chancellor Laster echoed Chancellor Strine in noting that Delaware judges have a "comparative advantage" in applying Delaware law. As a result, the Court of Chancery recently has refused to stay cases filed in Delaware in favor of earlier-filed actions in other state or federal courts.

We believe litigation will continue to increase, as the plaintiffs' bar continues to find M&A litigation rewarding, particularly in non-Delaware forums.

CFIUS/National Security Reviews of Foreign Investments in the U.S.

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Looming budget cuts in the United States, combined with the uncertainty related to the European fiscal crisis, will continue to pressure many industries toward consolidation, providing foreign companies with a number of attractive M&A opportunities in the United States. U.S. government representatives have continually underscored the necessity of foreign investment in U.S. companies, despite growing rancor (particularly between the U.S. and China) over U.S. national security reviews of certain foreign equity investments.

The Obama administration recently launched an initiative to attract $1 trillion in foreign investment over the next 10 years. The administration's desire to attract foreign investment will be balanced against growing concerns over the security of critical infrastructure, particularly sensitive communications infrastructure and the defense industrial base. The overwhelming majority of transactions continue to be approved by the interagency Committee on Foreign Investment in the United States (CFIUS), which reviews the national security implications of foreign equity investments in U.S. businesses. However, an ever-increasing number of cases are now subject to an additional 45-day investigation, and CFIUS agencies are imposing mitigation in a broad variety of cases involving sensitive communications infrastructure.

In the past year, we have seen increasingly rigorous scrutiny by CFIUS. Reports of widespread cyberespionage against U.S. government and corporate networks have fueled concerns relating to transactions involving telecommunications networks and technologies. Additionally, consolidation in the natural resources, telecommunications and critical technologies industries, coupled with heightened concerns over the security of the industrial supply chain and defense industrial base, have led to a more demanding examination of transactions in these spaces.

CFIUS forced the withdrawal of one transaction in 2011 after indicating it otherwise would be unwound post-closing. In February 2011, CFIUS prevented Huawei, a Chinese telecommunications company, from purchasing the assets of 3Leaf Systems out of bankruptcy. Additionally, CFIUS imposed mitigation on Mail.ru following its purchase of AOL's ICQ instant messaging service. In both of these cases, the purchasers failed to file a notice with CFIUS prior to closing the transaction.

Trends in the CFIUS Review Process

The Foreign Investment and National Security Act of 2007 (FINSA) mandated that CFIUS report annually to Congress regarding its activity for the prior year. 2011 was the third full year under the regulations the Treasury Department adopted to implement FINSA. Data from recent annual reports, and our experiences working closely with CFIUS, indicate that the increased cross-border investment activity in the fourth quarter of 2010 carried over into 2011, but growing sovereign debt concerns weighed on cross-boarder activity by year's end. CFIUS reviews in 2011

slightly outpaced the number in 2010, indicating an ongoing but fragile global recovery. Additional trends include:

- For the fourth consecutive year, the number of transactions that went to investigation increased. The CFIUS process consists of a mandatory 30-day review followed by a discretionary 45-day investigation period, which CFIUS can impose if it determines that the transaction might impair national security. CFIUS generally sends a transaction into investigation if it would result in foreign government control of a U.S. business, foreign control of "critical infrastructure" (as defined in the CFIUS regulations), or if the U.S. business has government contracts or access to classified information.
- More transactions were subject to mitigation agreements. In the past, CFIUS has entered into mitigation agreements with parties to transactions to address national security concerns identified during the review process. Mitigation agreements generally govern the foreign purchaser's access to sensitive information of the U.S. business and can affect operability and expected transaction synergies. The number of such agreements declined in 2009 but increased significantly in 2010.
- CFIUS was more active in demanding filings be made post-closing. The CFIUS process usually is initiated by a voluntary notice made prior to closing. In 2011, however, CFIUS became more active in demanding that filings be made post-closing when parties to sensitive transactions failed to file a notice. This generally results in suboptimal results for the parties. We strongly discourage clients from adopting a "chance it" mentality.
- The Department of Defense was more inclined to recommend that "proxy entities" be set up to run any U.S. business that requires access to proscribed information, *i.e.*, contracts or facility security clearances at the top secret, sensitive compartmented information, communications security or special access program level. While CFIUS does not publicly report the exact nature of mitigation it imposes in each transaction in which it requires mitigation, in our experience, the Department of Defense (a CFIUS member agency) has been more likely to recommend that proxy entities be set up to operate the U.S. business post-closing, particularly in cases in which a foreign government owns a significant interest in the acquiring company. Proxy entities are the most restrictive form of mitigation, and this trend reflects a growing requirement by the Department of Defense that its suppliers be cleared to access classified information. However, the Defense Security Service has been willing to discuss modifications to the standard form proxy agreement to provide the foreign parent with a greater and more versatile role in operating the U.S. business.
- The length of time it takes CFIUS to impose mitigation increased. FINSA requires that mitigation agreements be approved unanimously by all CFIUS member agencies. Because those agreements often reflect the concerns of one particular CFIUS member agency but not others, the unanimity requirement has had a pronounced effect and likely will continue to do so in 2012, especially if the number of transactions subject to mitigation agreements continues to grow.

"The CFIUS process usually is initiated by a voluntary notice made prior to closing. In 2011, however, CFIUS became more active in demanding that filings be made post-closing when parties to sensitive transactions failed to file a notice."

- Transactions involving allies of the U.S. continue to comprise a dominating plurality of transactions reviewed by CFIUS. Of the 93 cases CFIUS reviewed in 2010, 38 involved purchases by companies based in the United Kingdom, Canada or Australia. This trend likely illustrates a greater willingness by such nations' companies to make investments in U.S. businesses, but also highlights the interest CFIUS takes in transactions that might initially be perceived as "low risk."

As the necessity of foreign investment in U.S. companies continues to increase, the competing policy goals of encouraging foreign investment while protecting against national security risks will continue to play out in the CFIUS review process and as a central issue in foreign equity investments in U.S. companies. Buyers and sellers in transactions involving foreign purchasers are encouraged to plan ahead for CFIUS reviews by consulting CFIUS counsel as early as possible in their transactions.

Global Antitrust Enforcement in M&A Transactions

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In 2011, we saw a resurgence in antitrust challenges to mergers by the U.S. Department of Justice's Antitrust Division (Antitrust Division) and the Federal Trade Commission (FTC). The Antitrust Division sought to enjoin transactions such as Verifone's proposed acquisition of Hypercom (parties agreed to divestiture to settle litigation), Nasdaq OMX and the IntercontinentalExchange's proposed acquisition of NYSE Euronext (parties abandoned the transaction), H&R Block's proposed acquisition of TaxACT (Antitrust Division prevailed after full trial on the merits), and AT&T's proposed (and later abandoned) acquisition of T-Mobile. Similarly, the FTC litigated and lost a federal court challenge to Labcorp's consummated acquisition of Westcliff and lost its appeal in the Ovation Pharmaceuticals matter, where the FTC also litigated and lost a federal court challenge to a consummated acquisition.

From a practitioner's perspective, industry structure remains a critical starting point for merger analysis. Each of these challenges involved markets that the antitrust agencies alleged were highly concentrated, and descriptions in the merging parties' business and strategic planning documents frequently were cited as evidence supporting the agencies' views of market structure. In addition, the antitrust agencies (especially the Antitrust Division) have shown a willingness to "fast track" problematic transactions for litigation without the need for a prolonged review. For example, in the NYSE matter, the parties announced the proposed merger on April 1, 2011, and the Antitrust Division announced its intention to enjoin the transaction only six weeks later and without the voluminous documents and data required by the Second Request process. Finally, the health care industry continues to be a primary focus for the FTC, with all health care mergers — including those for which Hart-Scott-Rodino (HSR) filings are not required — typically receiving heightened antitrust scrutiny. We expect these trends to continue, irrespective of the outcome of the 2012 election.

Last year we also saw the first substantial revisions to the HSR premerger filing form in nearly a decade. The most significant of the revisions eliminate or reduce,

> "[T]he new [Hart-Scott-Rodino] rules have had limited impact on filing parties, except for those with international manufacturing operations … and private equity firms or master limited partnership buyers."

generally, the information and documents to be provided, but also require new, detailed information about (i) ex-U.S. manufacturing operations and (ii) "associates" of the acquiring filing person and their holdings, as well as the production of a new category of documents, called "4(d) documents," that include synergies and efficiencies analyses. The new rules remain subject to ongoing clarification, and we will continue to alert clients when the premerger office provides guidance as to the scope and interpretation of the rules. In practice, the new HSR rules have had limited impact on filing parties, except for those with international manufacturing operations, which must now itemize their overseas products and related U.S. revenues, and private equity firms or master limited partnership buyers, which must now account for associates' holdings.

Finally, the Antitrust Division issued a revised Policy Guide to Merger Remedies (Remedies Guidelines) earlier this year. The new Remedies Guidelines restate much of the Antitrust Division's precedents for devising, implementing and enforcing remedy provisions and consent decrees in the merger context. Released in part to highlight the Antitrust Division's approach to vertical transactions, which received significant attention following Comcast's acquisition of NBC Universal and Ticketmaster's merger with Live Nation, the Remedies Guidelines do not reflect a sharp change in the Antitrust Division's policies. Rather, they highlight the greater flexibility and willingness on the part of the Antitrust Division to accept conduct, as opposed to structural, remedies, particularly in connection with vertical mergers.

European Union

There have been no significant changes in terms of merger enforcement in the EU in 2011, which is now a "well-oiled machine" in Commissioner Joaquín Almunia's own words. Indeed, March 2011 marked two decades of enforcement of the EU Merger Regulation (EUMR), during which the European Commission (EC) reviewed 4,500 mergers and approved approximately 90 percent of them unconditionally.

Despite the fact that merger notifications increased slightly compared to 2010, last year was characterized by the deepening of the sovereign debt crisis and resulting recession in many EU countries. However, the crisis has not resulted in more lenient merger enforcement by the EC. This is evidenced by the prohibition of the *Olympic Air/Aegean Airlines* merger *(M.5830)* on the grounds that it would eliminate competition in many domestic air transport routes in Greece, the EU country at the epicenter of the EU financial crisis. As Commissioner Almunia has stated, the EC views effective merger control as a requirement for Europe to compete effectively in a globalized world economy, especially in times of recession.

In 2010, there was a lot of debate about whether the Upward Pricing Pressure (UPP) test introduced by the U.S. Horizontal Merger Guidelines would dispense with the need to define markets in the EU. The EC's practice since then shows that market definition will remain the starting point for merger analysis in the EU, and that UPP, along with other econometric tools, will complement rather than replace market definition. The *Unilever/Sara Lee Body Care* decision *(M.5658)* is an illustration of this approach. In that case, the EC defined markets and subsequently, through the use of econometric models and other evidence, concluded that the

merger would result in a price increase because some of the brands involved were close competitors. As a result, the EC required the divestiture of one of the brands in order to clear the merger. This approach is consistent with the U.S. approach, where industry structure remains a critical starting point for merger analysis.

On the remedies front, the EC has developed its practice of accepting nonstructural remedies to address foreclosure and interoperability concerns in nonhorizontal merger cases, even in Phase I, without a protracted Phase II investigation. In *Intel/McAfee (M.5984)*, the EC had concerns that Intel, after its acquisition of McAfee, would foreclose security solutions and CPU/chipset competitors through technical tying and/or degradation or refusal of interoperability, given Intel's position in CPUs/chipsets. To address these concerns, the EC accepted essentially interoperability commitments by Intel (i) to provide access to all necessary interoperability information for Intel's CPUs/chipsets, (ii) not to impede the operation of competing security solutions from running on Intel CPUs and chipsets, and (iii) to avoid hampering the operation of McAfee's security solutions when running on PCs containing CPUs or chipsets sold by Intel's competitors.

Despite the mature state of EUMR enforcement on the substantive front, there are still procedural issues that could affect both the timing and substance of merger review under the EUMR.

The EC's assessment of two parallel mergers in the hard disk drive (HDD) sector raised questions about the EC's "priority rule," a practice that it developed for parallel merger investigations. The mergers in question were *Western Digital/Hitachi (M.6203)* and *Seagate Technology/Samsung Electronics (M.6214)* (the WD merger and Seagate merger, respectively). The WD merger was announced on March 7, 2011, while the Seagate merger was announced on April 19, 2011. However, the Seagate merger was formally notified one day before the WD merger. As a result of the priority rule, which is based on a "first-come, first-served" approach, the EC assessed the Seagate merger as if the WD merger had not yet occurred, while the WD merger was assessed as if the subsequent Seagate merger already had occurred and Seagate/Samsung were a single entity. The strict application of the priority rule had a concrete impact, given that the WD merger was no longer assessed as a "4 to 3" deal, but instead as a "3 to 2" deal in certain HDD markets, and led to the imposition of remedies for the WD merger. In contrast, the Seagate/Samsung deal was assessed as a "4 to 3" deal and cleared unconditionally. The priority rule is under appeal before the European General Court by Western Digital, but in its current state, it complicates the antitrust risk assessment in M&A transactions that occur in oligopolistic markets with high barriers to entry.

Another procedural issue relates to transactions that do not automatically trigger the EUMR thresholds. Three of the nine Phase II decisions this year involved cases that did not trigger the EUMR thresholds but which were referred to the EC under Article 22 of the EUMR. Two of these decisions either resulted in significant commitments *(Sygenta/Monstanto Sunflower Seed, M.5675)* or were abandoned *(SC Johnson/Sara Lee Household Insect Control Business, M.5669)*. The increased tendency of national competition authorities in the EU to refer cases to the EC, including authorities that did not originally have jurisdiction to review the deal, is

a key parameter that could affect both the timing and substantive assessment of strategic M&A.

China, Brazil and India

China. 2011 was the third full year of enforcement by China's Ministry of Commerce (MOFCOM) of the Chinese Antimonopoly Law (AML). MOFCOM has continued to vigorously enforce the AML and establish its presence as one of the "gateway" competition authorities for global M&A transactions.

MOFCOM has increased its clout by taking enforcement action for the first time against a transaction involving a Chinese State Owned Enterprise (SOE). On November 10, 2011, MOFCOM imposed remedies for the establishment of a joint venture between General Electric and Shenhua (a Chinese mining/energy SOE), to license coal-water slurry gasification technology to industrial and power projects in China. MOFCOM cleared the joint venture subject to commitments by Shenhua not to compel licensees of competing gasification technologies to use GE/Shenhua's technology.

On August 29, 2011, MOFCOM adopted *Provisional Rules for Assessing the Competitive Effects of Undertakings*, which lays out basic principles for MOFCOM substantive merger review that reflect MOFCOM's experience so far.

However, despite the progress made on the substantive front, the MOFCOM merger review process remains very lengthy, even for transactions raising insignificant merits issues. The vast majority of the notified transactions in 2011 led to Phase II investigations because of the lengthy decision-making process, which involves interagency consultations with many other Chinese government agencies.

Brazil. The new Brazilian Competition Law (Law No. 12529) was adopted on November 30, 2011, and will enter into force on May 28, 2012. The new law will include, among other things, a bar on closing that will prevent the parties from closing a transaction before a clearance is issued. This will be a major change compared to the current system, which does not have an automatic bar on closing, and would put Brazil on the map as one of the key jurisdictions that could affect the timing of global M&A deals.

India. The Competition Bill of 2007, which amends the Competition Act, 2002, introduced a mandatory preclosing filing system that also applies to M&A transactions that do not involve Indian companies. The new regime entered into effect as of June 1, 2011. However, the number of Indian merger notifications triggered from global M&A transactions under the new regime is less significant than originally anticipated, due to a transitory *de minimis* exception that exempts transactions where the target company has Indian turnover or assets below certain thresholds.

China's Coming Wave of Going-Private Transactions

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Since October 2010, we have seen a sharp increase in going-private transactions for China-based companies listed on U.S. exchanges. At least 11 of these transactions have been completed or are publicly announced and pending. In addition to the hurdles presented by wholly domestic going private transactions, these deals present a range of execution challenges arising from the intersection of Chinese law and business practice with U.S. securities and corporate law.

Challenging Times for China-Based Listed Companies. Over the course of the last two decades, more than 300 Chinese companies have been listed on U.S. exchanges. Most of the public attention has been on prominent Chinese companies that already are state-owned or have been industry leaders at the time of their listing. Underwritten by international, bulge-bracket banks, these companies typically are audited by Big Four accountants, have large market capitalizations and receive meaningful coverage by research analysts. Another kind of company receives much less press coverage and, in terms of numbers, accounts for more listings — Chinese companies that have been listed by way of a reverse takeover by an existing public U.S. corporation. While Chinese companies generally have suffered in the markets, China-based reverse-takeover companies have performed particularly poorly, with the Bloomberg Chinese Reverse Mergers Index having fallen more than 50 percent in the last year. Many of the reverse-takeover companies never developed robust analyst followings and a small number have become the target of a new breed of analysts who actively sell short the shares of the companies they follow and then attack them. These firms purport to reveal weaknesses of Chinese companies, typically alleging accounting irregularities, fraud and insider dealing. In a number of cases, the SEC has initiated wide-ranging investigations into the affairs of these companies, although it is too early to generalize the results. The fact that there have been several widely covered cases where it appears that fraud indeed has taken place does not help.

The Going-Private Solution and Financing Challenges. As a result, many China-based companies have pursued (or are considering) the option of going private. Completed going-private transactions generally have been sponsored by a major shareholder, typically the founder of the company, working alongside a private equity investor and using a combination of debt and equity financing. While U.S. financing sources have significant experience with international leveraged acquisitions, most of the going-private transactions involving China-based companies have been completed with financing from Chinese financial institutions. The same factors that cause the capital markets to be unwelcoming to listings of China-based companies give international banks concern about lending in these transactions. The financing offered by Chinese institutions evidences confidence in such companies, but the success of transactions to date does not conclusively demonstrate that financing will be readily available for the much higher volume of transactions possible in the foreseeable future.

Short Analysts and Increased Scrutiny. The research analysts who specialize in critical reports on China-based companies often take short positions themselves. If the markets adopt their advice, they have a great deal to gain. Bidders find themselves increasingly concerned that, in response to these analysts' writings,

a financing source could be induced to withdraw its backing for the transaction or that an investigation could delay or derail the deal. Either of these events could damage the stock price, affording those with short positions the opportunity to close out their position at a substantial profit. On at least two occasions, an unexpectedly large negative shareholder vote has been attributed to attempts by these holders to quash a transaction.

To date, the SEC's public inquiries do not appear to be based on specific allegations of wrongdoing. The generality of the inquiries can make it difficult to provide adequate comfort to financing sources and the company's special committee. Because of these factors, combined with difficult accounting issues common to many Chinese companies, financing sources and the special committee often will demand extra diligence, including accounting reviews, forensic audits and inquiries that require the hiring of experts on a range of questions.

The Domicile Difference: Tax Issues. A number of reverse-takeover companies are domiciled in the United States, giving rise to issues that do not affect Chinese companies domiciled offshore (typically in the Cayman Islands). For example, companies domiciled in the United States are U.S. taxpayers. To the extent money made in China stays there, these companies may not pay any U.S. taxes, but following a going-private transaction, there may be a desire to flow funds up to an appropriate level, often a level above the U.S. entity, to service debt. Dividends received can create taxable income and dividends paid can attract withholding tax. Together, these taxes can affect the company's ability to service debt substantially and, therefore, its value as a leveraged entity. In the same vein, a reincorporation transaction to a tax haven jurisdiction can entail a 35 percent tax on built-in gain (*i.e.*, the prior appreciation of the value of the business under the U.S. shell), which often is prohibitive. Companies can employ a number of sophisticated approaches to ameliorate this tax exposure, but these are very much customized solutions.

What the Future Holds. Going private may be a highly attractive approach for many China-based listed companies, but the availability of financing, both from debt and equity financing sources, likely will remain a significant obstacle. If this hurdle can be overcome, these transactions should become progressively more common and provide more attractive opportunities to management and founders, prospective private equity investors and debt financing sources for investment in Chinese companies.