Insights: Publications

Regulatory Considerations for M&A Investors During COVID-19 Era

3-Part Series: COVID-19's Impact on US & Indian M&A Markets

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The COVID-19 pandemic and the corresponding economic volatility has dramatically impacted the US and the Indian M&A market. While many high-profile companies have abandoned proposed deals, various other companies have expressed or maintained interest in pursuing strategic acquisitions during this time. This article discusses the regulatory changes that parties should consider when contemplating M&A events in the Indian and the US markets in the wake of COVID-19.

Antitrust

USA: Federal agencies such as the Federal Trade Commission (FTC) and the Antitrust Division of the Department of Justice (DOJ) have not implemented any substantive changes for merger review during the COVID-19 era. However, the risk of antitrust infringement tends to increase during periods of economic disruption. Congressional rhetoric has also raised concerns regarding changes to the merger approval process. Senators Elizabeth Warren and Alexandria Ocasio-Cortez have spoken in favour of introducing the Pandemic Anti-Monopoly Act, which may temporarily prevent certain corporate acquisitions. Regardless of whether the proposed legislation comes to fruition (which at the present time seems highly unlikely), during this period of vast economic disruption, federal agencies are likely to take a closer look at merger filings, particularly for companies in the public health and biotechnology industries. Big Tech businesses are increasingly facing antitrust scrutiny, as their businesses continue to thrive in spite of the pandemic. As such, the House of Representatives antitrust subcommittee recently interviewed the CEOs of prominent Big Tech companies regarding alleged anti-competitive behavior and will produce a report with antitrust recommendations in August.

The FTC and DOJ released a joint statement, providing guidance for competitors cooperating in the interest of public health. The guidance specified certain joint activities that do not typically violate antitrust laws, including, but not limited to research collaboration, certain joint purchasing arrangements, and certain lobbying practices. The agencies also noted they will provide expedited antitrust review for businesses collaborating on projects in the interest of public health and related to combating the spread of COVID-19.

The FTC and DOJ have also issued a joint statement regarding the measures taken by the agencies to protect essential workers from certain labor market conduct during COVID-19. The statement made it clear that anticompetitive activities that may lead to wage suppression will be closely monitored and not tolerated. Although antitrust review continues, perhaps even with increased scrutiny, the government wants to encourage cooperation among businesses for the benefit of public health.

While the FTC has recently experienced a reduction in HSR filings, it is likely that once the dust settles, following this period of economic disruption, there may be an uptick in mergers, relying on the "failing firm" defense due to the economic conditions resulting from COVID-19. The "failing firm" defense has three requirements: (i) The competitor will be unable to meet its financial obligations in the near future, (ii) The competitor will not be able to reorganize successfully under Chapter 11 of the Bankruptcy Code, and (iii) The competitor has made unsuccessful, good-faith efforts to find another buyer that would keep its assets in the market and would pose less of a danger to competition than the proposed merger. However, the burden of proof for the "failing firm" defense is high and the FTC has advised that the agency will continue to apply the test as done in the past and will require the same burden of substantiation as prior to COVID-19. Thus, parties should be wary when providing this defense.

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While there have not been significant substantive changes to merger review in light of COVID-19, federal agencies have implemented various procedural changes. Further, in terms of merger review, the DOJ has requested parties to add an additional 30-day period to their deal timing. The DOJ moved to a telework model, under which meetings are primarily conducted through telephone or videoconferencing and the Hart-Scott-Rodino (HSR) filing process was moved to a new e-filing system. While review of HSR filings have continued, parties have experienced delays due to the COVID-19 disruption.

India: The Indian government has not implemented any changes to statutory timelines prescribed under the Indian anti-trust regulations on account of COVID-19 disruptions. However, the Indian anti-trust regulator (Competition Commission of India or 'CCI') has introduced a new e-filing system for merger control filings. The CCI has also made pre-filing consultations mandatory in most merger control filings to ensure minimization of delays in considering and approving combinations due to mandatory 'work from home requirements' and reduced staff capacities. However, hearings for anti-trust investigations on cartelizations / abuse of dominant positions have been adjourned until in person hearings are possible.

In response to the COVID-19 disruptions, however, the CCI has stated that arrangements between competitors that are "necessary and proportionate to address concerns arising from Covid-19" may not be seen as anti-competitive arrangements. For co-operation with competitors, the guidelines include assessing the scope of collaborations, detailed documentation and ex ante review by legal counsel. Dominant companies should avoid abusive / exploitative conduct by refraining from (i) limiting production, services or technical development, (ii) excessive pricing, and (iii) bundling non-essential products / services with essential services.

Foreign Investments

CFIUS Issues (USA): COVID-19 has also presented concerns that certain foreign investments may pose a risk to national security and the national economy. Department of Defense officials have emphasized on the need for Committee on Foreign Investment in the US (CFIUS) reviews to protect against "adversarial capital coming into our markets for nefarious means." While CFIUS has not implemented any specific legislation or policies to specifically address COVID-19, there have been other changes in the CFIUS regulatory climate. For one, there has been congressional activity in this realm, including a proposed bill intended to protect US companies from predatory Chinese governmental investment during the pandemic. Further, popular social media app TikTok is under CFIUS review due to national security concerns, given its Chinese ownership.

CFIUS, earlier this year, also finalized regulations implementing the Foreign Investment Risk Review Modernization Act (FIRRMA) from 2018. FIRRMA expanded CFIUS's review to include non-controlling and non-passive investments in specific types of businesses, including businesses involving "critical technologies," such as biotechnology companies, companies handling "critical infrastructure" and companies handling "sensitive personal data," like those with financial or medical information. Before FIRRMA, CFIUS filings were largely voluntary, however, they are now mandatory in certain instances. As such, the percentage of M&A transactions that require CFIUS review has increased in the past couple of years. In May 2020, the US Department of the Treasury issued a proposed rule, modifying the scope of the mandatory declaration provision for certain transactions involving critical technologies.

CFIUS has historically been concerned with protecting national security in a number of different contexts, including the defense and IT sectors. The current public health crisis is however likely to expand the agency's focus. In light of COVID-19, the definition of what may be considered "national security" is likely to be expanded to encompass a broader range of supply chains, including those affecting food supply chain, medical device manufacturing, pharmaceutical companies, and protective equipment. Further, certain FIRMMA regulations from February 2020 include provisions that expand CFIUS and FIRMMA, based on the invocation of the Defense Production Act (DPA). One of President Donald Trump's recent Executive Orders placed certain US medical and food production under the DPA, which potentially enables CFIUS' application to certain medical supplies and food production that currently fall under the DPA due to the said Executive Order.

The economic disruption and volatility caused by COVID-19 has also created potential CFIUS concerns. Many businesses have obtained government-backed loans provided by the CARES Act and other government relief programs, creating concern that a potential acquisition would make debt repayment less likely. There has also been an increased review in circumstances where the assets acquired in an acquisition are distressed or in bankruptcy, for fear of adversarial foreign investors. While CFIUS regulations carve out most lending transactions, CFIUS can assert jurisdiction when a borrower enters into default or a similar condition occurs, resulting in a potential foreign investor obtaining rights that mirror an equity investment.

Procedurally, there have also been several changes in the CFIUS review process. CFIUS is still subject to regulatory deadlines in the processing of cases. Notwithstanding these deadlines, the COVID-19 environment has resulted in practical delays. For example, the agency implemented a teleworking model and this can make coordination of a Committee with numerous agencies represented difficult. Parties with new CFIUS submissions should account for sufficient time for delays in their deal documents and understand how their deal is likely to be viewed by CFIUS. In certain instances, additional disclosures or discussions with CFIUS up front can help mitigate delays.

Press Note 3 (India): The Indian government sought to firewall Indian companies from Chinese capital by curbing 'opportunistic takeovers / acquisitions' of Indian companies. Pursuant to Press Note 3 (2020), direct / indirect acquisitions by entities whose ultimate beneficiaries are located in countries that share land borders with India are now subject to prior approvals from the Indian government. Implicitly, this amendment seeks to regulate inbound Chinese investments into Indian companies.

As the provisions of Press Note 3 (2020) do not grant any exemptions basis the extent of beneficial Chinese holding, it will also extend to LPs and GPs of private equity funds housed in China. Additional spill-over effects of Press Note 3 (2020) include its scope extending to foreign portfolio investors (beneficially held in China) undertaking transactions on the capital markets (market intelligence suggests that the government is seeking to regulate on market activity as well), and a lack of clarity on the status of investments from Taiwan and Hong Kong. Additionally, indirect foreign investments made by Chinese investors into Indian companies may also trigger approval requirements. As such, clarifications on these aspects are required and may vary from case to case.

Amid the COVID-19 pandemic, and instances of conflagrations at the Indo-Sino border, India has also banned a whole host of Chinese applications including Tiktok, PubG and WeChat on the grounds that they are prejudicial to India's national security and privacy concerns. Recent press reports suggest that India is also considering imposing trade controls on certain goods from China. This evolving India-China situation has resulted in difficulties in deal-making.

In some cases, parties are taking commercial deal positions on the basis of factors such as the extent of Chinese participation, nature of deal and rights acquired, etc., to close transactions without seeking approvals. The requirement of government approvals will significantly affect transaction timelines, with approval timelines being linked to industry sensitivity, investment nature and size, etc. Investee companies are also expending time and resources in undertaking diligences on the investing entities (including reviewing their constitution and holding structures) to assess Chinese participation. However, recent press reports cite government sources and provide that a 25% threshold for seeking approvals is being considered, but regulations / notifications in this regard are awaited. Cross-border financing transactions under the 'external commercial borrowing' route, however, have not been affected as they fall outside the purview of these regulations.

Changing M&A deal-making contours: M&A deal-making has changed course due to COVID-19, induced disruptions with deal activity being disrupted due to value erosion and acquirers choosing to invoke 'Material

Adverse Change' provisions to walk away from transactions (although a case-by-case assessment is required to identify whether a 'Material Adverse Change' has in fact been triggered). Parties that have proceeded to consummate deals have been met with delays in completion of pre-completion conditions (and a consequent re-prioritization of 'good to haves' vs 'must haves'), dilution of standstill obligations to enable target companies to firefight better and requirements of more robust information rights, given the inability of audits.

From a due-diligence and deal-making perspective, labor and financing aspects of target companies have taken centre stage. To insulate Indian borrowers from the aftershocks of the COVID-19 induced lockdowns, the Reserve Bank of India (India's central bank) allowed financial institutions to offer moratoriums on loan repayments (over two block periods till August 31, 2020). It is critical to understand the status of moratoriums actually granted by lenders to target entities and read the moratorium paperwork in consonance with the financing documentation. This is critical, especially since any delays in repayment after the permitted moratorium period will result in an immediate default by the target entity. Acquirers should also open channels of communication with the target entity's lenders to ensure that it is not exposed to the risk of the target company being pulled into bankruptcy proceedings mid-deal or post-deal.

Acquirers are also likely to focus on employment terms, appraisal cycles, contract commitments and hiring policies of the employees of target entities to assess instances of redundancies in the workforce. Legal due-diligence exercises are also focusing on the status of statutory pension payments of target companies (termed as 'gratuity' and 'provident fund') by assessing (i) non-payment/delayed payment of monthly provident fund contributions by the target entity, (ii) delays in making gratuity payments by the target entity (which may consequently trip insurance policies maintained to cover payment liabilities), and (iii) law suits brought by employees owing to delays in pension payments. Acquirers should carefully assess pension liability and labor compliances of target companies, especially in light of various relaxations that the Indian government has offered vis-a-vis pension payments due to COVID-19.

From a risk transfer / mitigation perspective, acquirers are also increasingly considering insurance policies to cover for transaction liabilities, especially on the back of COVID-19 induced business disruptions reducing costs of products, like warranty and indemnity insurance policies. While direct negative effects of COVID-19 are generally excluded form insurance coverage, general supply chain risks, financial stability and business continuity are fresh areas of focus for underwriting new policies. Tax liability and litigation insurances are also becoming risk mitigation products that acquirers are finding favorable for deal-making.

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