

Alerts & Publications

COVID-19 Antitrust M&A Considerations

May 7, 2020

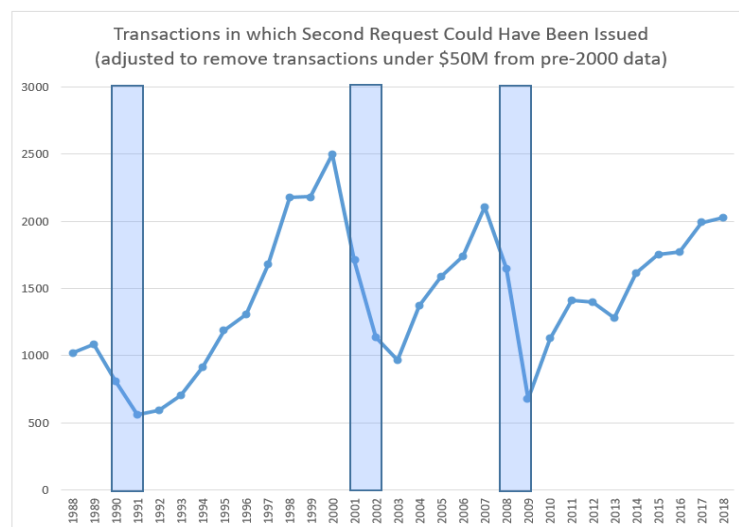


Recessions provide a unique environment for M&A activity. While global economy-wide M&A levels tend to decline,¹ there are pockets where M&A may be more important than ever, as crisis M&A can provide a necessary lifeline for a distressed firm or a unique opportunity for an acquirer looking to take advantage of depressed valuations. Speed, always essential in corporate transactions, may become an even more crucial factor for distressed M&A, which makes assessing the regulatory risks, particularly antitrust, critical. Most regulators worldwide apply the same level of scrutiny as during non-recessionary periods, but there are substantive and procedural opportunities that well-counseled acquirers and sellers can use to their advantage. Knowing what to expect from antitrust agencies around the world, how substantive doctrines such as the failing firm defense apply in times of crisis, and what procedural tools may be used to expedite review can help companies successfully navigate the M&A landscape during these uncertain times.

Agency Focus

The United States. Historically, US antitrust regulators investigate a higher proportion of transactions when the economy is under stress. Although the volume of transactions reported to the antitrust agencies drops during recessions (Figure 1), the percentage of eligible transactions that trigger an in-depth investigation (a “Second Request”) rises (Figure 2). Since 1988, four of the highest yearly Second Request rates (Second Requests as a percentage of eligible transactions) on record were either during a recession or immediately following a recession: 1990, 1991, 2002, and

Figure 1



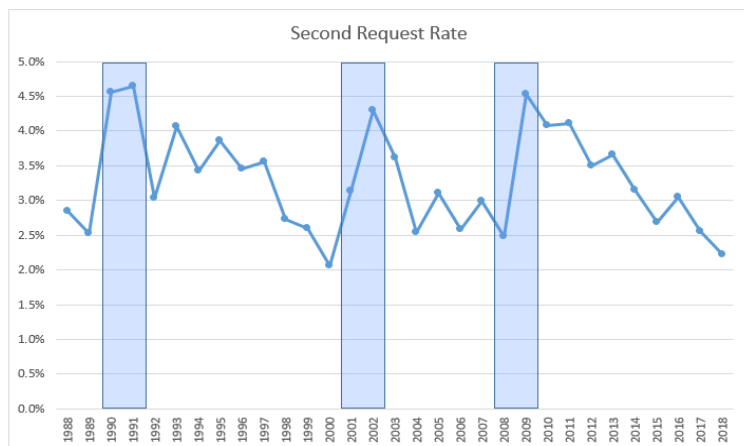
Recessions shaded in blue

Source: HSR Annual Reports, OMM analysis

Data points are for FTC fiscal years (October 1 – September 30)

¹ According to data provider Refinitiv, so far this year the worldwide merger activity is down 33% compared to one year ago and, at US\$ 762.6 billion, it is the lowest year-to-date amount for deal making since 2013. Kane Wu, Reuters, *Coronavirus Takes Toll on Global M&A as \$1 Billion Deals Disappear* (Apr. 20, 2020), <https://www.reuters.com/article/us-health-coronavirus-global-m-a/coronavirus-takes-toll-on-global-ma-as-1-billion-deals-disappear-idUSKBN2220LI>

Figure 2



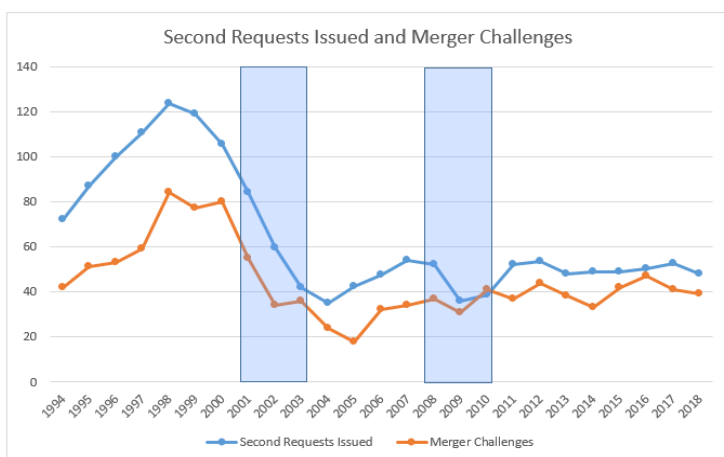
Recessions shaded in blue

Source: HSR Annual Reports, OMM analysis

Data points are for FTC fiscal years (October 1 – September 30)

2009. And, at least in the last two recessions, the agencies were tougher on those mergers that did receive a Second Request, with a smaller proportion of Second Requests resulting in unconditional clearances. (Figure 3). As for the current crisis, Federal Trade Commission (“FTC”) Bureau of Competition Director Ian Conner made clear that the FTC “will not suspend [its] usual rigorous approach to ferreting out anticompetitive harm and seeking appropriate relief, even in the face of uncertainty,” and that “emergency exceptions to the antitrust laws are not needed.”²

Figure 3



Recessions shaded in blue – the period immediately following the recession is also shaded because it may take 6-12 months (or longer) for a filed transaction to result in a merger challenge. To account for lag between Second Request issuance and merger challenge, the Second Request figure is the average of Second Requests issued in the year in question and the immediately preceding year. Merger challenges include suits to block merger, settlements, and instances where parties abandoned or modified the transaction in response to the agency’s concerns. Smaller gap between the two lines means that higher proportion Second Requests result in merger challenges.

Source: HSR Annual Reports, OMM analysis Data points are for FTC fiscal years (October 1 – September 30)

The European Union. The European Commission (“EC”) has repeatedly indicated that the EU Merger Regulation (“EUMR”) is an appropriate and sufficiently flexible tool for merger control enforcement, whether in normal times, or during and after a recession. Indeed, the EC has indicated that there is no need in these periods for special procedures to be adopted to review mergers, nor is there a need to amend the substantive test for approving mergers. As Neelie Kroes, at the time EU Competition Commissioner, stated in the midst of the 2008/2009 financial crisis: “it

² Ian Conner, Antitrust Review at the FTC: Staying the Course During Uncertain Times (Apr. 6, 2020), https://www.ftc.gov/news-events/blogs/competition-matters/2020/04/antitrust-review-ftc-staying-course-during-uncertain?utm_source=govdelivery.

is business as usual.”³ This was echoed recently in April 2020 by Jose-Maria Carpi Badia, Head of DG Competition’s Unit A/2 in charge of merger case support and policy, who said the EC has a “very good framework” for analyzing mergers, and that the EC’s focus is instead on ensuring business continuity.⁴

As with the US, there was a significant drop in the number of transactions notified to the EC in the wake of past recessions. For instance, while 402 mergers were notified in 2007, only 347 and 259 transactions were notified in 2008 and 2009 respectively. Based on the EC’s statistics, in the years following financial crises, the EC opens fewer Phase II investigations: For example in the post-financial-crisis years of 2009 and 2010, the EC opened respectively five and four in-depth investigations, respectively—, in comparison to eight in 2008.⁵

When reviewing transactions pursuant to the EUMR, the EC may approve the proposed merger unconditionally, approve it with remedies, or prohibit it. In times of financial hardship, the number of remedy cases and prohibitions stayed stable, showing no impact. While the EC has not changed its substantive assessment in times of economic difficulties, it has at times, depending on the specific circumstances of each case, adapted the type of remedies required. Indeed, the EC increasingly requested that divested businesses be purchased by upfront buyers (i.e., the parties can only close the main transaction once they have signed a binding sale and purchase agreement for the divestment business with a purchaser approved by the Commission), due to the uncertainty of finding a purchaser with sufficient financial resources to take over the divested business.⁶

Asia. In China, the current merger control regime has only been in place since 2008, making comparisons to past recessions difficult. As for the current crisis, State Administration for Market Regulation (“SAMR”) data shows that there is no impact (yet) on the number of cases cleared in 1Q20 compared to the same period in 2019 and 2018. The average review period for simplified cases in 1Q20 was actually shorter compared to prior years (around 12 days on average).⁷ However, SAMR has reportedly taken longer on average to clear standard cases in 1Q20, and saw a decrease in notifications of those cases over the same period. It is too early to tell whether the pandemic will have an effect on remedies, as most conditional clearances issued recently have involved pre-pandemic transactions. Thus far, SAMR continues to rely heavily on behavioral remedies (e.g., supply commitments, ensuring interoperability, bundling prohibitions etc.), among other remedies. Except for some procedural changes

³ Neelie Kroes, *Competition, the Crisis and the Road to Recovery* (Mar. 30, 2009), https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_09_152..

⁴ Charley Connor, *Coronavirus Is Hindering Merger Review, DG Comp Official Says*, Global Competition Review (Apr. 8, 2020) <https://globalcompetitionreview.com/article/1225285/coronavirus-is-hindering-merger-review-dg-comp-official-says>.

⁵ This was also the case after the 2000/2001 financial crisis. See European Comm’n, *Merger Statistics*, <https://ec.europa.eu/competition/mergers/statistics.pdf>.

⁶ For instance, this was the case in *Panasonic/Sanyo* in 2009, where the EC demanded that the parties divest a production plant for specific types of battery to an upfront buyer. In other cases, the EC also extended the divestment period to take account of the difficulty for the acquirer to find a suitable purchaser for the remedy package in times of economic uncertainty. For example, the EC granted an extension of the deadline for the implementation of remedies in the 2009 *Fortis/ABN AMRO* merger, in order to allow sufficient time for an agreement to be reached with Deutsche Bank to acquire Fortis’ corporate banking business and ABN AMRO’s Dutch factoring activities.

⁷ Information available on the SAMR website, <http://www.samr.gov.cn/fldj/>.

linked to the COVID-19 pandemic (discussed below), SAMR likely will not deviate from its merger control practice and apply the same level of substantive scrutiny to transactions.

In Japan, mostly in line with previous recessions, we do not expect the Japan Fair Trade Commission (“JFTC”) to amend its merger control practice. Broader political or economic considerations typically do not affect JFTC merger control.

In Korea, following the 2008 financial crisis, notifications to the Korea Fair Trade Commission (“KFTC”) dropped by 25% in 2009, before progressively increasing in 2010 and finding pre-crisis levels in 2011-2012.⁸ There is no indication that the KFTC relaxed merger control reviews during that period or that it will do so to face the current pandemic.

Failing Firm Defenses

The United States. While strategic transactions in concentrated industries do not receive any less antitrust scrutiny during a recession, those that are triggered by substantial changes to industry dynamics or economic distress are often eligible for potential antitrust defenses that play a particularly critical role in times of crisis. The failing firm defense,⁹ always available to merging parties in distress, looms larger in periods of economic upheaval. To establish the defense, the merging parties must demonstrate that: (1) one of the firms is in imminent danger of failure, which can mean it is about to enter bankruptcy or receivership; (2) the failing company has no realistic chance of a successful reorganization; and (3) there is no viable alternative purchaser that would pose less risk to competition. A similar defense applies to failing divisions of an otherwise healthy company. And even when the firm is not actually at risk of going out of business, but is so weakened that it will be unable to compete effectively going forward, a variant of the failing firm doctrine called the “flailing firm” defense may be successful. The exact evidence necessary to satisfy the flailing firm defense varies based on the circumstances, but has included a firm’s lack of resources required to compete long term, financial difficulties that constrain the firm from improving its competitive position, and poor brand image and sales performance over several years.

While the failing firm doctrine applies to all industries, some sectors receive special consideration. For instance, a less stringent standard applies for newspaper¹⁰ and banking¹¹ mergers, and a smaller risk of failure suffices to justify the transaction. The antitrust agencies also have issued specific guidance pertaining to hospital mergers, making clear that an acquisition of a hospital that is likely to fail absent the merger is generally not anticompetitive.¹²

The standard for establishing the failing firm defenses does not change during a crisis. But the facts necessary to invoke the defense are certainly more likely to arise during economic downturns, making the doctrine a particularly important part of the merger defense toolkit during recessions. For instance, on May 1, 2020, the DOJ announced that it would allow Prairie Farm to proceed with the acquisition of fluid

⁸ See Korea Fair Trade Comm’n, Fair Trade White Paper 2010, at 142 (Korean version).

⁹ For more details, see O’Melveny alert, *The Failing Firm Merger Defense in Times of Economic Turmoil: Past Lessons and the COVID-19 Crisis* (Apr. 23, 2020).

¹⁰ 15 U.S.C. § 1801 et. cet.; see also *Mich. Citizens for an Independent Press*, 868 F.2d 1285 (D.C. Cir. 1989) (interpreting “failing newspaper” test of Newspaper Preservation Act).

¹¹ 12 U.S.C. 1828(c); see also *United States v. Third National Bank*, 390 U.S. 171, 187 (1968) (under the Bank Merger Act, “a much smaller risk of failure than that required by the failing company doctrine” is required).

¹² U.S. Dep’t of Justice & Fed. Trade Com’n, *Statements of Antitrust Enforcement Policy in Health Care* at 9-10 (Aug. 1996).

milk processing plants from bankrupt Dean, noting that the collapse in milk demand from schools and restaurants is creating “a tumultuous time for the dairy industry” and that “the plants at issue likely would be shut down if not purchased by Prairie Farms because of Dean’s distressed financial condition and the lack of alternate operators who could timely buy the plants.”¹³ FTC Commissioner Noah Phillips recently acknowledged that invocations of failing firm defense are likely to increase during the current crisis: “You will see I am sure more failing firm defenses being made... I expect to see more of those because there are more failing firms.”¹⁴

Based on our analysis, summarized in Table 1 below, parties invoke some variation of the failing firm defense in merger litigation somewhat more frequently, and with a slightly greater chance of success, during economic shocks. With the corporate sector already burdened with a historically high debt-load going into the crisis, the failing firm defense may be particularly important during the current downturn.

Table 1

Invocations of failing firm or related defense in merger litigation: 1930-2019

	Number of times defense invoked	Success rate
Recession M&A	27	38%
Non-recession M&A	23	30%

Recessionary period defined as any calendar year during which the U.S. economy experienced a recession, and the calendar year immediately following the end of the recession; the year 1987 is included in the recessionary period due to the historic stock market crash. The date of the merger agreement (or the date the merger closed, in the case of post-close merger challenges), not the date of the case, is used to determine whether the transaction falls during a recessionary period.

The European Union. While the EUMR makes no explicit reference to a “failing firm” doctrine, the EC assesses the competitive impact of a concentration by taking into account the degree to which the allegedly failing firm would continue to be an effective competitive force in the market. From this perspective, the acquisition of a failing firm might be presented as a “rescue merger” and the only viable way to keep the assets of the firm in the market.¹⁵

The EU Horizontal Merger Guidelines set out a principle under which the “failing firm” doctrine is recognized, and point to three criteria for its application: (1) the failing firm would exit the market

¹³ U.S. Dep’t of Justice, Press Release, *Justice Department Requires Divestitures as Dean Foods Sells Fluid Milk Processing Plants to DFA out of Bankruptcy; Department Also Closes Investigation into Acquisition of Other Dean Plants by Prairie Farms* (May 1, 2020), <https://www.justice.gov/opa/pr/justice-department-requires-divestitures-dean-foods-sells-fluid-milk-processing-plants-dfa>.

¹⁴ Am. Bar Ass’n, Virtual Spring Meeting, *Where Do Vertically Integrated Digital Platforms End?* (Apr. 29, 2020), <https://ourcuriousamalgam.com/event-schedule/videocast-release-where-do-vertically-integrated-digital-platforms-end/>.

¹⁵ European Comm’n, *Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings* (May 2, 2004), <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A52004XC0205%2802%29>.

imminently because of its financial difficulties; (2) there is no less anticompetitive alternative to the notified proposal; and (3) in the absence of the merger, all the assets of the failing firm would exit the market.

Given that failing firm defenses often are raised at times of major crises, an increase in failing firm defense arguments being put forward to the EC can be anticipated should the COVID-19 crisis deepen. However, the EC has been very strict in applying this doctrine and it has cleared very few “failing firm” cases under the EUMR. Indeed, the EC has shown no flexibility or relaxation in the application of the failing firm defense principles even in the face of past recessions.

Instead, and similar to the “failing firm” doctrine in the US, the more relevant consideration could be one of a “fading firm” or “failing division,” - namely an argument falling short of a failing firm defense but where financial difficulties are nonetheless a relevant consideration to assess whether a firm can compete effectively in the future.

Asia. The failing firm defense has also been recognized throughout Asia and in particular in China, Japan and Korea. In China, SAMR requires merging parties to disclose whether the relevant transaction involves a “bankrupt firm” or “a firm on the verge of bankruptcy,”¹⁶ and the merger review regulations also require that SAMR consider a firm’s financial situation when reviewing mergers.¹⁷ In Japan, the JFTC’s M&A guidelines indicate that a company’s poor financial results are relevant to the assessment of a transaction’s competitive effects subject to certain conditions.¹⁸ In Korea, parties may invoke the defense provided they also meet a three-step test similar to the one applicable in the EU.¹⁹ Although we do not expect regulators to relax their approach to the failing firm defense generally, the KFTC accepted it recently in at least one case involving the distressed aviation sector (Jeju Air/Eastar Jet).²⁰

Declining Industry Considerations

Even when the circumstances do not warrant the application of a failing firm defense, declining industry performance can bolster many other arguments in support of a merger. Cost synergies, which always play a role in merger analysis, take on additional importance when savings are necessary to weather an economic storm. In an industry ravaged by declining demand, consolidation may be necessary to bring capacity utilization up to sustainable levels. Historical market shares may tell a misleading story when crisis causes a rapid reversal of fortunes, allowing the parties to contextualize high shares that would be an obstacle to clearance under ordinary circumstances. Put simply, the substance of antitrust analysis may not change, but particular arguments take on special meaning and significance in the context of an economic downturn.

¹⁶ State Administration for Market Regulation, *Notification Form for Anti-Monopoly Review of Concentrations between Business Operators*.

¹⁷ See China’s Interim Regulations on Evaluating Competition Effects of Concentrations of Business Operators, Article 5(6).

¹⁸ See Japan Fair Trade Comm’n, *Guidelines to the Application of the Antimonopoly Act Concerning the Review of Business Combination*, Part IV, § 2(8).

¹⁹ See Korea Fair Trade Comm’n, *Guidelines for the Combination of Enterprises Review* § VIII.2.

²⁰ Decision dated 23 April 2020. See http://www.ftc.go.kr/www/selectReportUserView.do?key=10&rptype=1&report_data_no=8536 (only available in Korean).

Procedural Considerations

The United States. Economic hardship also has procedural implications for mergers, particularly with respect to timing. Transactions under Section 363(b) of the Bankruptcy Code enjoy several procedural advantages over other deals: (1) the waiting period under the Hart-Scott-Rodino Act (the time the Government has for deciding whether to clear the transaction or issue a Second Request) is halved from 30 days to 15; (2) only the acquirer needs to comply with the Second Request; and (3) after the acquirer substantially complies with the Second Request, the Government has only 10 days to clear the deal or sue, rather than the customary 30 days. And unlike regular transactions, the parties do not even need to wait until they have a letter of intent, agreement in principle, or a contract before they file the proposed transaction with the agencies, which starts the clock on the waiting period; all that is required is attestation to a good faith intention to proceed with the transaction contingent on the bankruptcy court's approval.

The urgency of a bankruptcy sale can also accelerate the already-expedited merger litigation timeline, as demonstrated by the 2001 Sungard-Comdisco transaction. Sungard was competing against other bidders, and needed to resolve antitrust concerns prior to the court-ordered bankruptcy auction to put its bid on an even footing. After complying with the Second Request in only 18 days, Sungard proceeded to defeat the DOJ's merger challenge on a schedule virtually unheard of in federal litigation—a mere 23 days from complaint to final decision.²¹

The European Union. The EC has shown that it is willing to expedite the approval process of deals during financial crises. For instance, the agency approved the 2008 BNP Paribas/ Fortis deal two weeks before the normal deadline. The EC cleared this case subject to conditions that avoided narrowing consumer choice on the credit card market.

In addition, like many international merger control statutes, the EUMR prohibits the closing of a notifiable transaction until the EC grants merger control clearance (“standstill obligation”). However, it is possible for parties to request a “derogation” of this standstill obligation, and if the request is granted, the parties may close the merger before the EC issues a final decision.²² This provides an added measure of flexibility on timing in situations where delay may cause substantial harm to the merging firms or other interested parties.

The EC granted the vast majority of these derogations in the wake of the past economic recessions, with an increase of over 400% in the number of derogations granted during the 2001/2002 recession, and a 270% increase following the financial crash in 2008/2009.²³ Therefore, the increase in distressed M&A

²¹ The court summarized the accelerated timeline as follows: “[T]he parties proposed an ‘expedited’ discovery and briefing schedule: defendants answered the complaint five days after it was filed, all parties provided the reports of their experts one week after the filing of the complaint, fact discovery closed eleven days after the suit was instituted, and proposed findings of fact and conclusions of law were filed just two weeks after the filing of the complaint. . . . It has now been only slightly more than three weeks since the initial complaint and motion for a TRO were filed in this action.” *United States v. SunGard Data Systems Inc.*, 172 F. Supp. 2d 172, 179 (D.D.C. 2001).

²² For additional information on the derogation to the suspension obligation laid down in Article 7.3 of the EUMR, please see O’Melveny & Myers’ publication “Gun-Jumping Concerns For Pending Transactions When There Is No Such Thing As “Ordinary Course of Business”, dated Apr. 27, 2020.

²³ For instance, such a derogation was granted in the 2008 *Santander/Bradford & Bingley* deal, where the EC found that there was a real likelihood that without the deal closing, the latter company would cease to be a viable business and cause further disruption to the financial system. Similarly, the EC granted a derogation in the 2009 *Fiat/Chrysler* transaction to avoid irreparable damage to Chrysler and its distribution network.

activity resulting from the pandemic may well lead to a significant increase in the application of this derogation tool.

Asia. Regulators in China, Korea and Japan have a number of procedural tools to deal with merger control in times of crisis.

In China, SAMR has recently launched a fast-track channel to expedite merger reviews for transactions meant to accelerate the resumption of work and production, and for transactions in sectors closely related to the control of the pandemic (e.g., manufacture of pharmaceuticals and medical devices), sectors closely related to daily necessities (e.g., food and transportation), and sectors severely impacted by the pandemic (e.g., restaurants, catering services, hospitality, retail, and tourism).²⁴ In Japan, parties affected by the pandemic may ask the JFTC to shorten the relevant merger control waiting period; the JFTC routinely grants such requests for small to medium-sized deals where it is evident that they will not restrict competition. In Korea, similar to Japan, parties may ask for an expedited review if they are successful in convincing the KFTC of the necessity to close by a certain date—for instance because of certain considerations linked with the COVID-19 pandemic.²⁵

* * *

As the public health and economic crisis continues to unfold, O'Melveny will continue to monitor the developments relevant to antitrust M&A considerations so that we can effectively guide our clients through these uncharted waters. For instance, we are keeping our eye on the effect of COVID-related disruptions on agencies' review timelines and court dockets, proposals to impose moratoria on certain types of mergers, and the potential for greater protectionism as countries consider supply chain security in a wider range of industries.

At O'Melveny, our antitrust experts have significant experience in appraising and managing merger cases. Our in-depth understanding of how the EC, the Antitrust Division of the Department of Justice, the Federal Trade Commission, SAMR, JFTC, KFTC, and other agencies around the world work, and our established relationships with these agencies' staff, enable us to help our clients navigate the unique challenges posed by the COVID-19 crisis. If your company is contemplating a transaction, O'Melveny's global team of experienced antitrust practitioners would be happy to assist you in devising and executing a successful antitrust strategy.

²⁴ For more details, see O'Melveny Alert, *China Adopts Antitrust Enforcement Policy to Fight COVID-19 and Spur Economic Recovery* (Apr. 8, 2020).

²⁵ For more details, see O'Melveny Alert, *Gun-Jumping Concerns for Pending Transactions When There Is No Such Thing as "Ordinary Course of Business"* (Apr. 27, 2020).

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