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HORIZON SCANNING
2024 PROGRAMME

CAPITAL FLOWS

GOVERNANCE & SUSTAINABILITY

ENERGY TRANSITION

DIGITAL

CRISIS MANAGEMENT

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FOREWORD TO HORIZON SCANNING 2024

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Rising inflation, high interest rates, geopolitical turmoil and increased regulatory intervention have combined to make 2023 a challenging year. Yet, as the dust settles, businesses are adjusting to the new environment. We are cautiously optimistic that 2024 will see a less volatile market in which strategic M&A returns and private equity sponsors start to put capital to work at a greater pace.

While many may perceive regulation taking up ever more time and resources, the debate between a reduced state and a tightly regulated economy is not over. We are seeing efforts around the world to improve conditions for businesses, like the UK's proposals to enhance the competitiveness of London as a capital market or the holding-up of the proposed Audit and Corporate Governance Reform. But we are also seeing regulators around the World increasing their level of intervention and enforcement in merger control, consumer protection and data breach situations, to mention a few. Next year we expect to see an expansion in ESG-related legislation in the UK and Europe, changes on corporate criminal liability in the UK, and private capital will also become more exposed to regulatory scrutiny.

In this environment, risk governance and crisis management continue to play a crucial role. Businesses will be exposed not just to threats that have become familiar, like shareholder activism and cyber-attacks, but also risks such as workplace misconduct crises and increasingly creative litigation claims for perceived disclosure or directors' duties failings. And known threats keep evolving: activists are renewing their playbooks, cybersecurity has seen the emergence of state-aligned actors along with a renewed focus on ransomware gangs, and claimants are finding novel ways to use the collective proceedings regime.

Not all is doom and gloom for 2024; we see plenty of opportunities as well. The energy transition is perhaps the greatest, with estimates that annual capital investment of US$3.4 trillion will be needed to hold global warming at 1.5°C. This represents an opportunity for both sponsors looking to deploy their capital, and corporates aiming to decarbonise their operations. Besides the traditional forms of renewable energy technologies and infrastructure, such as national grids and interconnectors, there are some exciting opportunities in hydrogen and carbon capture, utilisation and storage technologies that we cover in this publication.

There are other technologies that keep revolutionising the business world. In 2023 we saw ChatGPT come to life, and in this new year we will start to understand better its potential for all businesses. Across the globe we are seeing existing AI regulation being tested in the courts, and we expect new legislation and further guidance in 2024. Adopting AI and other emerging technologies entails digital transformations for corporates that require good governance and effective risk mapping.

We hope that you find our 2024 Horizon Scanning Programme useful and timely. It is designed to help guide decision-making, inform the approach to risk and identify new angles and opportunities. If you would like to discuss any of the issues that we cover, please do not hesitate to contact us.

We wish you a very successful 2024.

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M&A: OVERVIEW OF 2023 AND 2024 OUTLOOK

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Although 2023 has seen a decrease in both transaction volume and average transaction value, this has largely been driven by the decline in private equity activity. By comparison, the volume of corporate-to-corporate transactions has stayed more stable, with just a 15.9% decrease globally and a 6% decrease in the UK (for the first three quarters compared to 2022).

The outlook for 2024 is looking healthier. While we expect market uncertainty to continue as high interest rates remain, M&A activity is likely to increase, driven by distressed M&A, an abundance of PE dry powder, corporates seeking strategic acquisition opportunities and ESG and digital transformations.

M&A TRENDS IN 2023

Fears of a global recession in the early part of the year (exacerbated by the turmoil in the banking sector following the collapse of Silicon Valley Bank and merger of Credit Suisse and UBS), and the impact of high interest rates, led to market uncertainty for much of the year. Deal value was down globally, with few mega-deals announced in 2023, but deal volume for corporate-to-corporate generally remained strong.

Some sectors, in particular, saw plenty of M&A activity throughout the year. Energy and power was the busiest sector (accounting for 14.5% of deal value in Q1-Q3) while the healthcare sector saw a 29% increase in deal activity compared to 2022.

The slow-down in private equity M&A saw the take-private boom of UK-listed companies of recent years drive to a near halt as sponsors sit on their capital and await market stability. Instead, acquirers have generally been peers looking for strategic acquisition targets. Across the board, the increased cost of debt led corporates to consider structuring transactions as all-share mergers or by way of equity funding, as an alternative to debt financing.

As we look ahead to 2024, although not expecting a return to 2021 levels, we are optimistic that we will see a rise in M&A activity driven by the following factors.

DISTRESSED M&A

Distressed M&A is predicted to increase in the first half of 2024 as high interest rates remain and companies are forced to siphon off under-performing non-core assets to raise funds for operational capital. Thinly capitalised growth companies will be especially affected, which could have a knock-on effect on corporates dependent on such companies for outsourced services.

DRY POWDER

The slow-down of PE activity in 2023 has resulted in unprecedented levels of dry powder for sponsors. As the market becomes less volatile with the expectation that higher interest rates are here to stay, sponsors are likely to take advantage of lower valuations and seek to deploy capital on new opportunities. Similarly, we expect to see a number of PE exits in 2024 as the market begins to stabilise and sponsors look to crystallise their investments.

STRATEGIC ACQUISITIONS AND DIVESTMENTS

2024 is likely to see even more strategic acquisitions, particularly bolt-ons and peer-to-peer M&A, as companies look to synergise and reduce ongoing costs given the current economic climate. Well-capitalised companies may take advantage of current market conditions to consolidate targets in their core businesses. In a similar vein, public companies may look to the high synergy potential of all-share combinations to provide some valuation flexibility in a difficult market.

As companies look to streamline their strategy with a focus on reducing costs, we expect to see more complex carve-outs (with de-mergers as possible dual tracks) allowing corporates to exit non-core businesses and creating opportunities for PE sponsors to acquire mid-sized standalone businesses.

OTHER FACTORS

We expect to see more ESG focused transactions in 2024 as the energy transition drives corporates to reconsider their sustainability goals and as governments look to provide financial support to material infrastructure projects.

We also expect digital transformation and AI to be a key driver of M&A activity as companies consider how to digitalise their offerings. However, regulatory hurdles may deter material transactions by Big Tech and other players seen to have a dominant position, especially in retail sectors where the authorities are increasingly focused on the less affluent consumer as the cost-of-living crisis continues.

MORE SOPHISTICATED M&A

As a result of these factors, we expect many of the M&A transactions in 2024 will involve experienced counterparties and be targeted in nature. As debt financing will not be a viable option for many purchasers, transactions may require alternative financing (whether equity or vendor financing) and are likely to be more complex as a result. We expect well-capitalised buyers to have a strong hand in negotiations of price and terms.

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CHINA OUTLOOK 2024

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MACROECONOMIC OUTLOOK

2023 was a year characterised by above-average global inflation and rising interest rates, tepid domestic demand, structural stresses in the property market and geopolitical tensions for China.

The first quarter of 2023 saw only US$3.2 billion of new greenfield investment deals, a decline of 34% compared to the same period in 2022 and a fall of 75% relative to 2021. This trend continued in Q3 2023, as China reported a foreign direct investment deficit of US$11.8 billion, the first quarterly deficit since figures were first published 25 years ago.

Unsurprisingly, dealmaking activity was subdued with Greater China (including Hong Kong, Macau and Taiwan) recording 702 M&A deals worth US$62.3 billion for the first eight months of 2023, with total deal volume declining by 124 deals and an aggregate decrease in transaction value of 13% versus the same period in 2022.

Analysts predict that similar macroeconomic factors will continue to inhibit M&A activity in 2024 with China's GDP forecast to grow by 4.6%. This matches forecasts for slower GDP growth in Asia's developing economies in 2024.

RECENT DEVELOPMENTS IN CHINA

Notwithstanding the economic headwinds, recent developments in China offer some optimism of a rebound in M&A activity in 2024.

"China + 1" Approach but Continued Significance of China

China remains the top trading partner for more than 120 countries. Its share of global GDP in 2022 was around 18.8%, and China is forecast to contribute around 35% of global growth in 2023, after the annualised GDP growth of China exceeded expectations in the third quarter of 2023.

Against this backdrop, many foreign investors still view access to China's market as crucial to their growth, even though they are increasingly looking to manage their exposure by diversifying their geographical footprint. This was reflected in the recent survey by the European Union Chamber of Commerce in China, which revealed that only 0.2% of respondents are looking to divest fully from China and that one in 10 respondents report that they plan to diversify their future supply chain-related investments but will not make changes to their existing supply chains in China.

Foreign investors are increasingly adopting a "China + 1" approach in a bid to diversify and strengthen the resilience of their supply chains. Countries such as Vietnam, Thailand, Indonesia and India are popular destinations for establishing alternative destinations. There are, however, some lingering concerns in some of these alternative destinations, including tariffs, the experience and skill of the labour force and the quality of the logistics infrastructure. It is probably unreasonable to expect, at least in the short to medium term, that any single country would be able to match the scale of China as the "world's factory".

While a "China + 1" approach suggests a reduced dependence on Chinese producers, due to the diversification of supply chains and reduced direct trade with China, data suggests that reliance on - and exposure to - Chinese producers may not have changed materially. The transshipment of goods through third party countries have correspondingly risen and Chinese companies have been embedding themselves in Southeast Asian supply chains. As an example, the Vietnamese government reported that Chinese firms invested in 45 new projects in Vietnam in the first 50 days of 2023 alone. The reduction of dependence on China's producers resulting from the "China + 1" approach may not have been as significant as expected and might only seek to deepen the links between China and its new trade partners.

China's Initiatives to Attract Foreign Investment

The Chinese government has rolled out a full range of initiatives in 2023 to attract foreign investment, boost the economic growth and improve investor confidence.

In March 2023, the "Invest in China Year" campaign was launched to give foreign investors a better understanding of the investment opportunities in China.

In July 2023, the Communist Party of China and the Chinese government vowed to improve conditions for private businesses, primarily by treating them in a similar way to state-owned enterprises.

In August 2023, the State Council released a new policy framework, titled "Opinions to Further Optimise the Environment for Foreign Investment and Increase Efforts to Attract Foreign Investment" which seeks, amongst other things, to improve the foreign business environment and ensure fair treatment of foreign investors so as to achieve an optimal investment environment and boost investor confidence. Key measures include: exempting foreign investors from taxes if the profits earned in China are reinvested; ensuring that foreign enterprises enjoy equal treatment as local enterprises; and clamping down on intellectual property rights infringements.

President Xi also pledged in November 2023 to remove foreign investment barriers and foster a market-oriented, law-based and world-class business environment.

While it remains to be seen how the slew of policies will be implemented - and while it will take time to restore the confidence of foreign investors - in a country where top-down signalling is both vital and effective for clearing of roadblocks, the developments in 2023 are a positive sign from the Chinese government to investors that it is open for business again.

Stabilising US – China Relations

Against a backdrop of tariffs, export controls and sanctions, both countries have recognised the need for stabilising their relationship following a prolonged period of heightened political tension. An agreement by the Chinese and US heads of state to continue on a path of diplomacy and co-operation, following a meeting which took place in November 2023, is an encouraging sign for investors.

Investments by New Economic Partners

A fall in foreign direct investment from companies in the US and nations with strong ties to the US, may allow other nations and economic blocs to partner with China. It is estimated that the Gulf Cooperation Council countries, whose sovereign wealth funds total around US$4 trillion in collective capital, will increase their investment in China, and may reach as much as 10% to 20% of total foreign direct investments by 2030. The signing of bilateral agreements worth US$10 billion between China and Saudi Arabia (a nation with traditionally close ties with the US) at the Arab-China Business Conference in 2023 is an indication of their willingness to deepen economic cooperation.

CAUTIOUS OPTIMISM FOR THE RETURN OF CHINA'S M&A MARKET

The macroeconomic difficulties are apparent but the continued significance of China to the global supply chain and recent developments such as the raft of policy measures introduced by the Chinese government to bolster an economic recovery and a recent Xi-Biden meeting do represent some reasonable bases for some cautious optimism for China's M&A dealmaking in 2024.

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REGULATORY HEADWINDS FOR M&A

M&A deals are facing greater regulatory scrutiny, hurdles and delay than ever before. In 2024 we expect this trend to persist as the consequences of recent developments in the fields of merger control, foreign investment and subsidy control continue to unfold.

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MERGER CONTROL

Competition authorities worldwide are increasingly sceptical about the benefits of mergers, especially in concentrated industries. The UK Competition and Markets Authority (CMA), for example, intervened in over half of the mergers that were subject to a formal review in 2023, i.e., the transactions were prohibited, abandoned, or required remedies to secure clearance. Across the channel, the European Commission (EC) intervened in around a fifth of the non-simplified procedure cases it reviewed in 2023.

This interventionism is being driven by:

- concerns around previous under-enforcement, particularly in the tech sector
- a focus on the impact on innovation, particularly in tech and life science mergers
- renewed interest in vertical and conglomerate effects, and on non-price theories of harm
- uncertainty no longer being seen as a reason not to intervene

Increased interventionism is playing out both in terms of competition authorities adopting ever broader approaches to claim jurisdiction over global transactions, and through novel approaches to substantive reviews.

The CMA, for example, is willing to adopt creative approaches to establish its jurisdiction over cases where the target does not generate any turnover in the UK. One party acquiring 'material influence' over another is sufficient to intervene, giving the CMA further flexibility. Moreover, in 2024, the Digital Markets, Competition and Consumers Bill will **introduce** a new jurisdictional threshold to allow the CMA to review more vertical and conglomerate mergers.

In Europe, the EC now has a policy which allows it to examine deals where the jurisdictional thresholds are not satisfied in Brussels or the Member States. The EC used this policy to block Illumina's $8 billion acquisition of GRAIL - a US/US deal which did not satisfy the thresholds for merger control review anywhere in the EEA. The EC announced in August 2023 that it had accepted referrals of two further below-threshold transactions using this policy (*Qualcomm/Autotalks* and *EEX/Nasdaq Power*). We anticipate more of these referrals in 2024 and beyond as 'gatekeepers' are required under the Digital Markets Act to report transactions in the tech sector to the EC.

From a substantive perspective, in addition to intervening in respect of horizontal mergers, authorities are increasingly ready to intervene on the basis of complex theories of harm across vertical or adjacent markets. For example, the EC's recent prohibition of *Booking/eTraveli* showed a willingness to depart from established guidelines and consider novel 'ecosystem' theories of harm. This interventionist trend is likely to continue meaning we can expect in 2024 further uncertainty in respect of merger control outcomes for complex cases.

A final hurdle that is here to stay is the need to make parallel notifications in some cases in both the EU and the UK. This requires careful management given that over one quarter of the cases notified to both authorities have seen some form of divergence in the outcome. In particular, conflicting approaches to remedies have seen the two authorities disagree on the necessity or acceptability of remedies in major cases like *Broadcom/VMware, Facebook/Kustomer* and *Microsoft/Activision Blizzard*. More generally, authorities around the world are taking a stricter approach to remedies. Proposals are being subject to detailed review, up-front buyer commitments are required in many cases, behavioural remedies are unlikely to be accepted and there is increasing scepticism about the acceptability of carve-out remedies.

FOREIGN DIRECT INVESTMENT

Recent years have seen a significant increase in countries equipping themselves with foreign investment screening regimes. Most recently Belgium, Estonia, Ireland, Luxembourg, the Netherlands, Slovenia and Sweden adopted legislation to establish new regimes. This trend is likely to continue in 2024 and beyond given geopolitical tensions, security of supply concerns and the presence of state-funded investors amongst other factors. Bulgaria and Greece, for example, are reported to be working on the development of screening regimes. The EU Foreign Direct Investment Regulation is also subject to revision soon. Since coming into force, it has led to more cooperation between European and national authorities, greater awareness of FDI issues and an increased prospect of national authorities tipping off their counterparts in other countries about transactions that may not have been notified.

The scope of investments that come under these regimes has also increased in many countries meaning that more transactions are now subject to mandatory reviews. Depending on the jurisdiction, reviews may cover direct and indirect stakes, minority investments, acquisitions of assets, real estate transactions, and joint ventures, among others. New technologies such as AI, data infrastructure, quantum computing and semiconductors, have joined traditional sectors for screening such as defence and energy.

Although more deals are now subject to foreign investment review, most transactions do not require remedies to secure clearance and only a handful are blocked each year. The UK government's **analysis** shows that, among the 866 notifications made under the National Security and Investment Act in the period between April 2022 and March 2023, around 1% of deals required some form of remedy, around 1% were withdrawn by the parties, and less than 1% were prohibited. In the EU, the EC's **analysis** shows that among the approximately 800 cases that were formally screened by EU Member States in 2022, around 9% were subject to a remedy, around 4% were withdrawn and around 1% were prohibited.

SUBSIDIES

The EU's **Foreign Subsidies Regulation** (FSR) came into effect in July 2023. The FSR regime is intended to address distortions in the EU internal market caused by foreign subsidies.

Beginning in October 2023, the FSR introduced a new suspensory regime for acquisitions of companies with EU turnover of at least €500 million involving parties in receipt of substantial financial contributions from non-EU governments (at least €50 million across all relevant parties in the previous three years). Financial contributions are defined widely and include measures such as revenue from provision of goods/services, tax concessions, soft loans, support for the development of production facilities, funding for R&D initiatives, etc. Once a notification is made, the EC assesses whether the financial contributions entail a "subsidy". If the subsidies are found to distort the internal market, the EC can block or impose conditions on the transaction.

The FSR also includes a 'general market investigation tool', which allows the EC to investigate lower-value concentrations and all other market situations where a distortive foreign subsidy may be involved. In 2024 we will continue to see the effects this new regulation has on the market.

IMPACT ON TRANSACTIONS

The increased number of regulatory hurdles that now apply to many transactions calls for the careful planning and execution of an appropriate regulatory strategy. This is crucial to avoid unforeseen delays and uncertainty. It is important for parties to analyse their position under all applicable merger control, foreign investment and subsidy regimes at the early stages of transaction planning. This exercise should be carried out for acquisitions of minority holdings, as well as acquisitions of control.

Various factors can have an impact on the likelihood of intervention, including the structure of the transaction, the identity of the merging parties, the impact on competition or national security, and the prevailing political context. Careful attention should also be given to the relevant gun jumping rules which apply to a wide range of transaction structures.

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CAPITAL MARKETS

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A year ago, the Chancellor launched the "Edinburgh Reforms" with the stated ambition of making the UK "the world's most innovative and competitive global financial centre". Regulatory zeal for reforming London's capital markets continued throughout 2023, most notably with the **FCA's proposed changes to the listing regime**, which were outlined in May and further developed in December, and the HM Treasury-commissioned **independent review of financial services investment research**.

The reiterated recognition in the Autumn Statement that improvements to the legal framework and broader financial markets ecosystem are necessary to attract new companies to list in the UK - and to encourage UK-listed companies to retain their UK presence - is shared across government departments and regulatory authorities. Encouragingly, in light of the upcoming UK election, the reform initiatives enjoy bipartisan support from the two main political parties.

The 2024 outlook is one of cautious optimism: with the expected introduction of long-awaited reforms, and continuing government support, we are hopeful of renewed equity capital markets activity in the coming year. Increased debt market activity is also expected to be generated by many of the companies that tapped into the equity markets during COVID-19 and now face increasing refinancing pressures in the coming 2024/25 financial year which cannot be met by shareholders again.

ATTRACTING AND RETAINING EQUITY LISTINGS

In late December the FCA announced that it will press ahead with the proposals it consulted on in May 2023 in respect of collapsing the premium and standard segments into a single segment for Equity Shares in Commercial Companies (ESCC). The ESCC rules will be based mainly on the current premium segment rules, but some requirements will be modified or dropped entirely. Final rules will be published "at the start of the second half of 2024" and come into force two weeks later. Existing listed companies will be "mapped" to one of the new listing categories that will be created.

In a move which will significantly improve London's competitiveness vis-à-vis other listing venues, there will be greater flexibility on dual class share structures, which are common in overseas markets and popular with founders who wish to retain post-IPO control of their creations. Companies that currently have a premium listing will no longer need to obtain shareholder approval for significant or related party transactions, which will improve the competitiveness of London-listed bidders for assets in cross-border transactions relative to peers around the world.

The new regime will place greater emphasis on disclosures driven by, and tailored to, the shareholder base and investor expectations for individual businesses by encouraging proportionate and thoughtful disclosures, rather than prescribing a "one-size-fits-all" approach. This may result in greater scrutiny on how directors discharge their duties in relation to decision-making on transactions. Until now, the need to obtain shareholder approval for significant and related party transactions has provided a measure of legal and practical protection; once such approval is no longer required, boards will need to decide for themselves whether a proposed transaction will be welcomed by shareholders and how much information should be publicly disclosed.

In addition, the positive impact of the FCA reforms in attracting both homegrown talent and overseas businesses seeking liquidity remains contingent on FTSE Russell concluding that the current eligibility criteria for inclusion in the FTSE indices will remain broadly the same for the new ESCC segment. No timeframe has been given for FTSE Russell's deliberations. Institutional investors are generally limited to investing in companies with a market indexation, and it remains to be seen whether the traditional strength of the UK FTSE regime over its less predictable US counterparts will be maintained.

Concerns in 2023 about the state of UK capital markets were fuelled, in part, by the decision of UK-grown and headquartered ARM to list in New York. Although a handful of companies announced they would transfer their primary listing to the US, each had business-specific reasons for doing so, and the vast majority of UK-listed companies have retained their primary listing in London.

SUPPORTING LISTED COMPANIES

The efficiency with which much-needed funds were raised by LSE-listed companies during COVID-19 prompted the Pre-Emption Group to update its Principles in November 2022 - as recommended by the Secondary Capital Raising Review (**SCRR**) - to allow companies to seek annual authority to issue up to 20% of their share capital on a non-pre-emptive basis (instead of the 10% previously permitted). While take-up of the additional headroom during the first year of implementation was cautious, particularly among FTSE 100 constituents, we expect take-up to increase during the 2024 AGM season.

Many other recommendations made by the SCCR are yet to be implemented. There is general consensus among listed companies, regulatory authorities, market practitioners and other stakeholders that, while London has a good track record of supporting equity capital-raisings, the documentation and process requirements for raising larger amounts of equity through a rights issue, an open offer or other documented placing structure is unnecessarily costly and burdensome. Consultation on reforms to the prospectus regime and other efforts by HM Treasury and the FCA to streamline the current framework is expected to continue in 2024.

DEBT CAPITAL MARKETS

The key area of focus for the debt capital markets will be the upcoming reforms to the prospectus regime. The draft statutory instrument, The Financial Services and Market Act 2000 (Public Offers and Admission to Trading) Regulations 2023 will, among other things, grant the FCA power to make rules about various prospectus-related matters: see our December briefing. We have been involved in preliminary discussions with the FCA on how it will use these powers, and a formal consultation is expected in 2024. As the current debt regime functions relatively well, the FCA will be seeking to make targeted improvements to the regime, with one of its more ambitious plans being proposals to revive the retail bond market in the UK (see our May briefing).

IMPROVING THE BROADER ECOSYSTEM

Through TheCityUK Capital Markets Group and The City of London Law Society, we are engaged in industry-led initiatives to nurture London's broader capital markets ecosystem. This includes improving the quality and availability of investment research and encouraging retail participation through PrimaryBid and other platforms, all of which contribute to valuation and the overall attractiveness of London as an investment prospect. We hope that 2024 is a positive year for confidence in the London capital market.

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PRIVATE CAPITAL: ADVERSITY AND OPPORTUNITY

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Financial sponsors have enjoyed an unprecedented era of benign market conditions. A powerful combination of cheap debt, assets in plentiful supply and comparatively light-touch regulation have supercharged investment activity, valuations and returns. However, as Oaktree's Howard Marks observed over the summer, "the easy times – and easy money – are largely over".

Harder fundraising markets, increased regulatory scrutiny and less favourable macro-economic conditions will undoubtedly present challenges in 2024. There is, however, overwhelming pressure for financial sponsors to transact. Some are under pressure to liquidate investments and return capital to investors who may be over-exposed to private equity due to the so-called denominator effect triggered by the sell-off in public equities. The value of un-exited assets is at a record high, with limited partners increasingly impatient and pushing sponsors to achieve realisations rather than waiting longer for valuations to rise. Others will feel recently raised funds burning a hole in their pocket, as the industry as a whole seeks targets for more than $1 trillion of dry powder. For many, it will be both.

ADVERSITY

As the private capital industry looks to 2024 and beyond, there are a number of significant challenges on the horizon:

- **Uncertainty:** The macro-economic environment remains volatile. Ongoing geo-political instability is a source of great concern; upcoming elections in the UK and US introduce considerable uncertainty; and fiscal and financial policy agendas to combat inflation, implement extensive quantitative tightening and manage ballooning national debt all reduce conviction in financial models, requiring more prudent assumptions at the expense of up-front valuations.
- **Availability of capital:** For many, it is proving harder to raise new capital as investors are increasingly selective about who they choose to back. A trend towards fewer, larger funds, raised by an elite group of sponsors, will fuel consolidation amongst asset managers. We saw several of these transactions in 2023, including TPG's acquisition of Angelo Gordon and Bridgepoint's acquisition of Energy Capital Partners, and anticipate more over the next 18-24 months.
- **Increased regulatory intervention:** The private capital industry is high on the regulatory agenda. Financial regulators are seeking to improve transparency and impose more extensive protections for investors. Competition regulators have a stated agenda to investigate so-called 'platform' or 'roll-up' strategies involving the acquisition of multiple, smaller businesses

that would not typically trigger regulatory approvals. We have already seen direct intervention in some markets, such as dentistry, laundry services and veterinary clinics, and may see more as regulators broaden their focus. All of this in addition to a harder stance on the application of general merger control powers. Since its commencement in October 2023, the EU's FSR will also add a new, complex, and potentially onerous dimension to the scrutiny and clearance of larger deals.

- **An evolving financing market:** Although the end of the cheap debt era has not yet resulted in the wave of casualties gloomily predicted a year ago, we have seen both borrowers and lenders reassessing previously available borrowing multiples. The high interest rate environment has led to a focus on free cash flow and a borrower's ability to meet higher levels of debt service now operates as a constraint on borrowing (alongside financing EBITDA). Whereas previously, interest cover covenants (if included in documentation) did not attract much commercial attention, we now see both borrowers and lenders focusing on these covenants much more closely (and the potential for breach of existing covenants arising). The challenge for dealmakers will be to find the means to bridge the gap between the valuation multiples attaching to assets and available borrowing multiples.

OPPORTUNITY

Over the next 12-18 months, we anticipate a significant increase in the volume of transactions backed by private capital. Within these deals, we expect to see a number of themes emerge:

- **Competition for quality:** Current market conditions favour the strongest operating businesses. This will, in our view, renew focus on true 'alpha' investing, requiring detailed operational due diligence and post-acquisition enhancement as the primary route to generate value, rather than buy-and-build strategies reliant on multiple arbitrage (in effect, buying low and selling high). We expect real competition for assets displaying these characteristics, as we saw recently when acting for Inflexion on its sale of Chambers and Partners.
- **Smaller deals, harder fought:** We anticipate a trend towards comparatively smaller deals – something we have already observed in the P2P market as interest in FTSE350 and AIM companies has intensified, including from larger sponsors through acquisitions funded entirely by equity. We may also see greater complexity in transactions as sponsors seek to realise arbitrage opportunities. This may occur at the asset level (e.g. complex carve-outs) or through the capital structure of investments (e.g. increasing use of complex capital instruments such as convertible preferred securities in lieu of more conventional mezzanine finance).
- **Investing through the stack:** Sponsors with multiple strategies covering private equity, tactical/strategic opportunities and private credit are likely to be well-positioned to take advantage of current conditions. As seen in several recent, larger deals (EQT and ADIA's £4.5 billion offer for Dechra Pharmaceuticals plc and Permira's £703 million offer for Ergomed plc), sponsors have shown a willingness to deploy capital from different pockets across their business to support investment throughout the capital stack. This arguably simplifies underwriting and execution, minimises fee leakage and supports sponsors' global AUM.
- **Fund liquidity solutions:** With a period of slow market conditions, sponsors will continue looking for innovative solutions to generate liquidity for their investors while the M&A market slowly picks up, such as through NAV facilities and other fund financing products or GP-led secondaries transactions. This is more likely to provide shorter-term solutions, as LPs put pressure on asset realisations and increasingly assess sponsors on performance measures (such as distributed paid in capital) that seek to assess returns generated by the asset rather than relying solely on IRR.
- **Financing:** The wave of financing activity that occurred during COVID-19 is now approaching maturity, with a number of borrowers expected to need to refinance, or seek an amendment and extension package, within the next 12 months. This presents opportunities across the credit spectrum. In particular, we see the growth of funds targeting 'special situations' and 'hybrid capital' as offering opportunities for private capital to step in and provide risk-adjusted bespoke solutions to complex or stressed credits.

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PENSIONS DERISKING: PLANNING FOR AN ACCELERATED JOURNEY

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Levels of activity in the UK pensions derisking market in 2023 are on course to eclipse previous records, both in deal size and overall volumes (the previous record being £43.9bn in 2019). Projections are that market volumes could exceed £60bn in 2024 and continue to rise. This reflects trends in other jurisdictions including the US, which has also seen record volumes of pension risk transfer in recent years.

Activity in the UK market has also been supported by US and Canadian groups seeking to insure the liabilities of their UK defined benefit pension schemes (as we have seen in our work on transactions involving Intact and Walgreens Boots), which in some cases can be viewed as paving the way for potential M&A activity.

Dramatic improvement in scheme funding levels, in the wake of the 2022 mini-budget and subsequent gilt crisis, mean that many UK defined benefit pension schemes are now fully funded or above a funding level of 90% on a "buy-out" basis.

Scheme trustees may now intend to transfer risks to an insurer on an accelerated timeline, compared to previous journey planning. A well-advised corporate sponsor of a pension scheme should consider taking an active role in this process and appointing its own legal and actuarial advisers. This will help to ensure that it can shape the process and outcome, with its interests being reflected in the deal shape and terms, rather than leaving the Trustee and its advisers to progress a potential transaction independently.

By doing so the sponsor can overcome what are otherwise two material unmitigated risks. Firstly, the Trustee shaping and negotiating the asset size and terms solo, with the sponsor continuing to have the contingent funding liability for the scheme. Secondly, the governance and analysis of the underlying risks and their mitigation being contracted out to the Trustee board. Involvement from an early stage, with the governance that the sponsor would normally bring to bear on material asset acquisitions (through its board and treasury, legal and other functions), will help to ensure that the sponsor's interests are taken into account.

INSURING SCHEME RISKS AND SPONSOR'S ROLE

A corporate sponsor of a defined benefit pension scheme needs to consider whether its objectives are truly aligned with the trustee's, both in terms of whether, when and how much to insure and the process, pricing and terms for the insurance transaction.

A large derisking project is akin to major M&A. The trustee is the transferor of assets and liabilities pursuant to a 'buy-in' policy, selecting a preferred insurer with which to transact from a competitive process and agreeing price and other terms for the deal. Once the premium is paid, the trustee has no assets beyond any contingency reserve established for the scheme, so the Sponsor is contingently liable for the consequences of these terms. This includes liability if the insurer defaults prior to issuing individual annuity policies to scheme members (known as 'buy-out'), as well as for any uninsured unknown liabilities that emerge in the future.

A sponsor will also need to ensure that the trustee's plans align with its own objectives, including on residual risks, the accounting impact and the approach to any surplus in the

scheme, which may be trapped if the sponsor continues to make contributions after buy-in. From a governance and reputational perspective, the sponsor needs to not only be aware of, and support, these consequences, but also to influence their outcome by being front and centre of a joint working approach from the outset of the project, rather than becoming engaged at a later stage when the shape of the transaction is already formed.

"BIG BANG" APPROACH

RSA/Intact case study

- Single buy-in covered **40,000 members** and **c.£6.5 billion of liabilities** across two RSA schemes (February 2023)
- Pensions Insurance Corporation selected following competitive process
- c.£500m contribution from Intact
- Significant issues of timing and complexity, including structure to accommodate existing longevity and asset swaps and illiquid assets
- Sponsor-led process, working collaboratively with both trustees and their advisers to agree insurer-facing position

Key features of a "big bang" process

- Focus and engagement by principals akin to a major M&A process on a similar timeline
- Maximises competitive tension pre-exclusivity
- More flexibility on very large deals to negotiate terms beyond what is "market"
- Accelerated timetable to capitalise on market pricing windows
- Commitment of resources (internal and external) necessary to achieve this
- Collaborative approach required to develop and test innovative solutions rapidly

STRATEGIC PARTNERSHIP APPROACH

Tata Steel UK case study

- Four buy-ins under umbrella terms took cover to **c.£7.5 billion of liabilities** and **c.67,000 members** (Nov 2021 to May 2023)
- Coordination between insurer, trustee and sponsor throughout period to optimise pricing, asset and data preparation, transitioning investments and due diligence
- Scheme's investment management transferred to insurer's in-house asset manager prior to full insurance
- Sponsor and advisers fully engaged in negotiations throughout to ensure a satisfactory outcome for the corporate

Key features of a strategic partnership

- Soft/non-binding commitments from insurer to facilitate future transactions
- Often alongside umbrella terms / tranches, but could be used for single large buy-in
- Prioritised within insurer's business plan, (e.g. sourcing best assets, accepting illiquid scheme assets, bespoke terms)
- Increased transaction readiness, resources and transparency from the insurer
- Requires sufficiently strong relationship with insurer and support from advisers to mitigate reduction in competitive tension

Key things to manage for derisking transactions with very large pension schemes

- Illiquid assets of a scheme (e.g. property, derivatives) – insurer's ability to accept these assets and scheme's ability and optionality to maximise their value
- Existing scheme arrangements (e.g. insurance arrangements, asset swaps)
- Appetite for and availability of certain deal terms (e.g. residual risks cover, security from termination rights/collateral, deferred premium)
- Insurer ability to transition scheme assets / source sufficient assets and reinsurance capacity
- Regulatory engagement/scrutiny for insurers on very large deals
- Right-sizing internal and advisory teams, including to facilitate insurer due diligence process
- Governance, preparedness and managing expectations – including sponsor/trustee dynamics

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THE LONG AND WINDING ROAD TO UK AUDIT AND CORPORATE GOVERNANCE REFORM

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It was Spring 2018 when, in the immediate aftermath of the failure of Carillion, Sir John Kingman was called upon to undertake an independent review of the UK's Financial Reporting Council (**FRC**), kicking off a whole series of reports, white papers and consultations on proposed reforms to various parts of the UK audit and corporate governance framework. Delays, a global pandemic and three prime ministers later, it seemed that changes to UK corporate governance may finally be falling into place for 2024, only for the journey's end to be once more obscured by a bend in the road in the second half of 2023 with the last minute withdrawal of the SRDR Regulations and consequent implications for the proposed changes to the UK Corporate Governance Code (**Code**).

The schematic on the following page sets out key steps along this long and winding road.

The Government published its response to the BEIS (as it was then) White Paper, "Restoring trust in audit and corporate governance" setting out its plans for reform in May 2022. This set a path to UK corporate governance reform through a combination of primary and secondary legislation and changes to the Code.

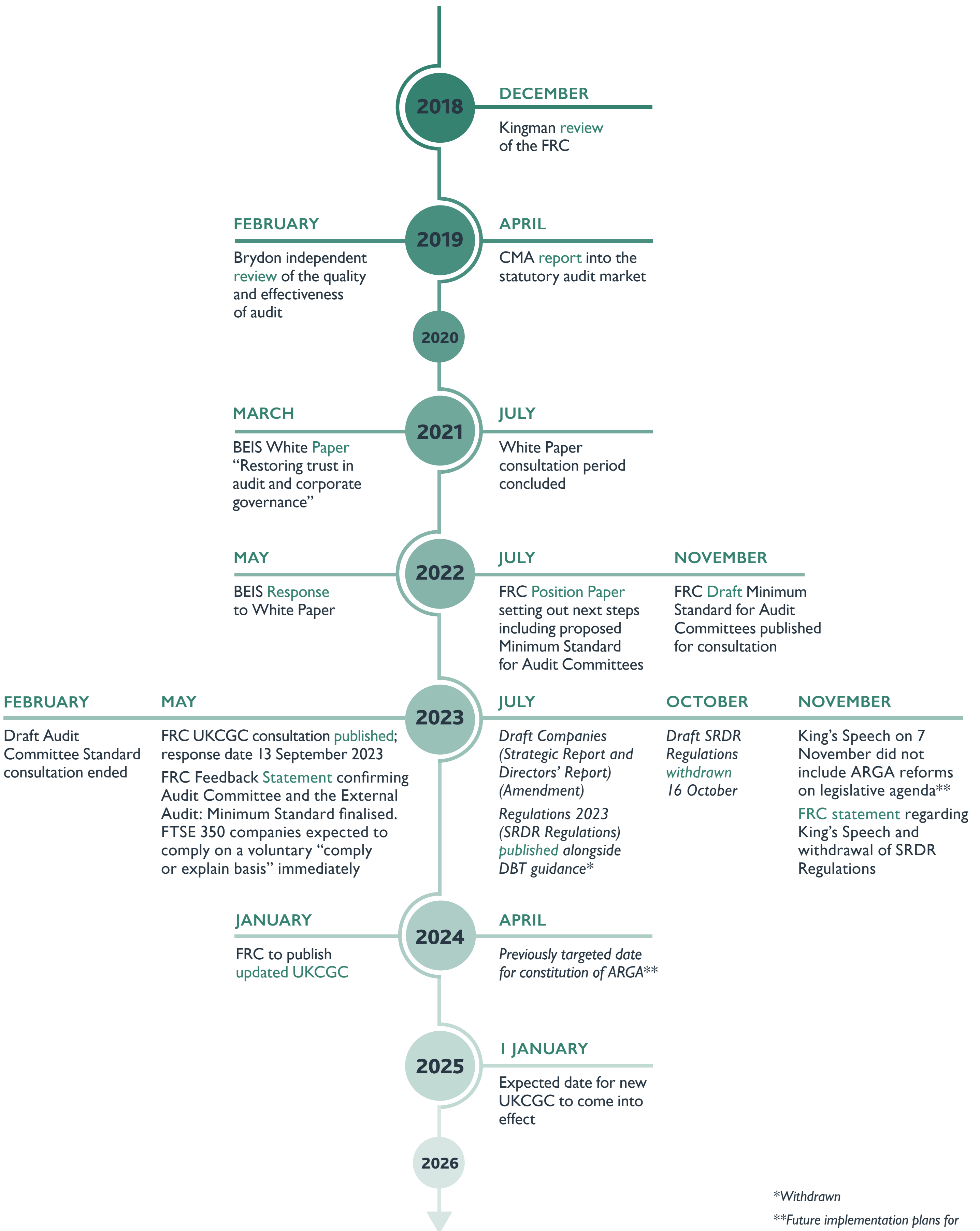
The FRC released a consultation in May 2023 setting out proposed changes to the Code, reflecting what the Government wanted the FRC to cover. New corporate reporting requirements were due to come into effect through the Companies (Strategic Report and Director's Report) (Amendment) Regulations 2023 (**SRDR Regulations**), published in July. As part of the implementation plan, primary legislation was needed to transition from the FRC to the new Audit, Reporting and Governance Authority (**ARGA**). That transition had provisionally been targeted for April 2024.

However, a day before the SRDR Regulations were scheduled for parliamentary approval, the Government withdrew them, citing a need to "cut red tape" for business.

The decision of the Department of Business and Trade (DBT) to withdraw the SRDR Regulations encapsulates the current tension between a call from some sectors of Government to restore trust in audit and corporate governance (in the wake of perceived failings and the high-profile corporate collapses of Carillion and Thomas Cook), and the desire and focus in other quarters to (re-)position the UK, in general, and the London capital markets, in particular, internationally as a more attractive and efficient place to do business.

The SRDR Regulations contained several key reporting requirements that were part of the reform agenda. Companies in scope (public companies and private companies above certain employee and turnover thresholds) were to be subject to new annual reporting requirements, including amongst other things a "resilience statement" and annual distributable profits figure.

AUDIT AND CORPORATE GOVERNANCE REFORMS



The FRC's proposed amendments to the Code were mainly aimed at providing for a more robust framework of effective internal control and risk management (as requested by the Government in its response to the BEIS White Paper back in 2022). Arguably they went further than anticipated by extending audit committee responsibilities and other changes focusing on diversity, directors' time commitments and the quality of corporate governance reporting. Importantly, several of the proposed Code changes relied on the SRDR Regulations being in effect.

The withdrawal of the SRDR Regulations therefore had an inevitable knock-on effect on the FRC's proposals for updating the Code. On 7 November, the FRC announced that although it would still be targeting January 2024 for publication of the updated Code, it would be taking forward "only a small number" of its 18 original proposals – namely those aimed at reducing duplication across reporting standards and ensuring internal control standards are "targeted and proportionate". This aligns with the messaging from the DBT, which following a Call for Evidence in May 2023 looking at overlap and duplication in non-financial reporting requirements, has signalled that it intends to look into streamlining existing frameworks and eliminating duplicative requirements in companies' directors' and strategic reports (reinforcing the view that the focus on economic competitiveness is prevailing in Government for now).

Such pressing of the pause, if not the re-direct, button, was further evidenced in November by the absence of mention of the Audit Reform Bill in the King's Speech. The anticipated creation of ARGA next year will now not happen. The message from Government continues to be that the relevant legislation will happen 'when Parliamentary time allows'; however, that seems quite far away, despite the FRC gearing up for its change to ARGA for a number of years now.

The timing and extent of audit and corporate governance reform is therefore far from clear, though perhaps this should be of no surprise with the prospect of a generation-defining general election in the UK in 2024. The current appetite within the ruling Conservative Party is uncertain. The Labour Party has pledged support for the audit and corporate governance reform agenda, including the establishment of ARGA, but not as a priority action item. One thing that does appear certain is that it will take a back seat during the run-up to the UK general election. And it seems unlikely that any new, far-reaching reforms will be developed and implemented immediately following the election.

The journey that started in 2018 with Sir John Kingman to reform the FRC and the UK audit and corporate governance framework is therefore set to continue through 2024. Though that may cause concern and frustration for some, if a rethink and rebalancing of the proposed reforms leads the UK to a better door at the end, this long and winding road may well have been worth it.

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THE ECONOMIC CRIME AND CORPORATE TRANSPARENCY ACT – WHAT YOU NEED TO KNOW

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CORPORATE CRIMINAL LIABILITY REFORM

The most important changes from a corporate criminal liability perspective are: an expanded identification principle – the test for attributing liability to a corporate for crimes with a mental element; and a new offence of failure to prevent fraud. These reforms create a powerful package, which should make it easier for corporates to be prosecuted for economic crimes in the UK.

New Identification Principle

Previously, a corporate could only be guilty of offences with a mental element where the offence was committed by someone considered to be the company's 'directing mind and will'. This was generally regarded as those at statutory board level.

The Act introduced a new test such that a corporate will now be liable if one of its 'senior managers', acting within the actual or apparent scope of their authority, commits an economic crime. This effectively lowers the threshold for the type of employee who can trigger criminal liability for a business.

The definition of 'senior manager' is loose and there is a lack of clarity around who will constitute a senior manager for these purposes. Assessment of whether an individual meets this test will need to focus on the extent of their decision-making power over the business in the context of the alleged offence.

This change is already in force, having come into effect on 26 December 2023. At present it only applies to economic crimes including, bribery, money laundering, sanctions offences and fraud. However, we may see a further expansion of the principle sometime in 2024 via a new Criminal Justice Bill. The Bill, which is currently before Parliament, proposes to expand the new senior manager test to all criminal offences, not just economic crimes. If this proposal becomes law, it will raise complex questions about the scope of senior managers' duties and whether certain offences such as sexual offences, if committed by a senior manager at work, could lead to corporate prosecution.

Failure to prevent fraud

Under the new 'failure to prevent' offence an organisation will be liable where a person associated with it (such as an employee, agent or subsidiary) commits a fraud with the intention of benefiting the organisation, or those to whom it provides services (eg. its customers or clients). It will

not be necessary to show that the organisation's leaders authorised, knew about, or even suspected the fraud. Importantly, an organisation will have a defence if it can prove it had reasonable procedures in place to prevent the fraud. These concepts of associated person and a reasonable (or adequate) procedures defence may be broadly familiar from the UK's Bribery Act 2010, but corporates should be aware that the new offence has some subtle differences in these concepts, as well as a different territorial scope.

The offence applies to 'large organisations' only (defined in line with the Companies Act 2006). This captures corporates that are themselves a large organisation and subsidiaries of a large organisation (even where the subsidiary alone does not meet the threshold). The result is that the vast majority of our clients will be in-scope of the new offence.

The offence is expected to come into force in mid-2024 after the Government issues guidance on the reasonable procedures defence.

EXPANDED POWERS FOR THE SFO

The SFO already has the power to compel information at the pre-investigation stage, but only in cases of suspected international bribery and corruption. Under the Act, this pre-investigation power is expanded to all SFO cases – capturing fraud and domestic bribery and corruption cases. This will likely result in an increase in the number of companies receiving pre-investigation compulsory notices from the SFO.

COMPANIES HOUSE

A large portion of the Act deals with reforms to Companies House, taking it from a passive repository of information to a more assertive regulator. The Act gives enhanced powers to the Registrar to query or remove information from the register, and introduces, amongst other things, new identity verification requirements and changes to company record keeping requirements. Implementation of many of these changes requires secondary legislation - which is expected over the next 12-24 months. Companies will need to do a significant amount of housekeeping and ensure their internal processes are ready for this new regime.

OTHER REFORMS

The Act also introduces a host of other significant changes including:

- **Information sharing provisions for regulated firms**: which will better enable firms to share customer information with each other for the purposes of preventing, investigating and detecting economic crime.
- **Cryptoassets**: new powers for enforcement agencies to freeze and seize cryptoassets which are the proceeds of crime or associated with illicit activity.
- **Reforms to limited partnerships**: including changes to the process for registration and additional transparency obligations.

The Act introduces sweeping reforms, only some of which are discussed here. The changes to the corporate criminal liability regime are particularly significant. The new director of the SFO, who has already made an assertive start to his tenure, may well feel pressure to use these new tools sooner rather than later. However, it remains to be seen whether these will be enough to turn the tide on the SFO's recent difficult history and make it a more formidable prosecutor of corporate crime.

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ESG IN 2024: MATURITY, CLARITY AND UNCERTAINTY

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Over the course of 2023, the concepts of ESG, and sustainability more broadly, evolved to reflect and anticipate developments in society, governmental policy and corporate decision-making and strategy.

We expect 2024 to be no different. The world's view of ESG will likely be tested against the backdrop of the anti-ESG movement in the United States, U-turns in UK governmental policy in the context of the cost-of-living crisis and the ongoing conflicts in the Middle East and Ukraine.

Yet, these developments are unlikely to slow down the pressure from investors, lenders, regulators, and sectors of society that see ESG as a priority. For this reason, in 2024 expectations on companies to create adaptable strategies and ensure that they deliver on their ESG commitments will be even higher, and many have already demonstrated resilience in meeting their commitments.

The current focus is on listed companies, public interest entities and the finance sector, but private companies (particularly large private companies) are under increasing pressure to re-evaluate their businesses, disclose more information and revisit their governance structures accordingly to cater for the risks and opportunities presented by the sustainability agenda.

To help businesses make sense of the various challenges and opportunities presented by ESG, in 2024 we have collected our thoughts around three key themes: **maturity, clarity** and **uncertainty**.

MATURITY

We have sensed from conversations with our clients a marked shift towards implementation and operationalisation of ESG, regardless of political and economic uncertainties and ongoing regulatory evolution. Whilst the political environment fluctuates (particularly with significant elections coming this year, including in the United States) stakeholder expectations are no longer focused solely on whether businesses must transition, but rather how to transition and how fast.

Those businesses plotting a path for their transition most successfully often start with their purpose, strategy and commercial proposition in mind (i.e. a sophisticated view of sustainability, opportunity and risk). They understand this will require increasingly focused sustainability leadership from the board and the senior management team. The Transition Plan Taskforce's (**TPT**) framing of Ambition, Action and Accountability (see further below) captures the zeitgeist. Businesses that get ahead of the regulation on transition plans will have the prospect of differentiating themselves positively.

It is likely that 2024 will see a new language of corporate communication emerge, reflecting a focus on delivery and achievement beyond the mere articulation of ambition. This will be driven by the increasing expectation of assurance, the spotlight on delivery and the widespread focus on, and increasing negative consequences of, greenwashing.

Our sense is that, once the current suite of contemplated UK regulatory initiatives are consulted on and implementation processes are commenced (notably endorsement of the International Sustainability Standards Board (**ISSB**) standards, TPT, TNFD (defined below), Sustainability Disclosure Requirements and a UK Green Taxonomy), the stock of domestic transparency and reporting regulations will stabilise. The UK Government's pillars of strategic action for green finance, being 'greening finance' and 'financing green' have been furthered, with measures to ensure that market participants have the information and data that they need to manage risks and allocate capital where there are opportunities. Climate finance, and in particular the private sector's role in providing such finance, was also a key theme of **COP28**: **Discussion points for business from week 1**, **Impacts for business** . Good market practice will continue to develop, with a collaborative approach from regulators and amongst businesses.

2023 saw a consistent voice from multiple business sources, trade associations and stakeholder platforms for more meaningful regulatory intervention, ranging from calls for a comprehensive industrial strategy, to better support for particular energy transition technologies, to a more ambitious regulatory framework to incentivise transition. We expect this to continue as businesses see the opportunity that sustainability presents, the need to progress their transition and the demands of their stakeholders to do so.

CLARITY

Corporate ESG reporting frameworks will continue to evolve in 2024 and will benefit from greater clarity from regulators, albeit that it is unlikely that full clarity will emerge by the end of the year.

Regimes like the Taskforce on Climate-related Financial Disclosures (**TCFD**) will merge into more prescribed regulatory content via the European Sustainability Reporting Standards (**ESRS**), the ISSB standards, the TPT framework and such like. Despite imperfect interoperability, each new framework calls for improved transparency through more detailed disclosure requirements (including in respect of scope 3 emissions, the subject of a UK Government call for evidence that closed at the end of 2023), assurance processes and materiality assessments.

The ISSB has published its sustainability and climate change disclosure standards, which may become the global baseline for sustainability reporting in many jurisdictions, including in Brazil, Japan, South Africa and the UK. The EU has gone a step further, adopting a "double materiality" approach via the Corporate Sustainability Reporting Directive and ESRS, requiring disclosures about the impact a business has on people and planet, not just what is financially material. The US Securities and Exchange Commission (**SEC**) is yet to publish its climate rules. Reporting on biodiversity is also expected to develop, as companies get to grips with the recommendations of the Taskforce on Nature-related Financial Disclosures (**TNFD**), published in September. Human rights and supply chain integrity will also go up the reporting agenda.

Finally, disclosure of transition plans is likely to see major growth in 2024. The UK's TPT has published its "gold standard" sector-neutral transition plan disclosure framework, which offers businesses a better sense of how wider stakeholder expectations are likely to be set, and how to satisfy or exceed them. The TPT's guidance on legal considerations for transition plans preparers (to which Slaughter and May contributed) also offers guidance on how to account for directors' duties and competition law when making transition plan disclosures. This will be supplemented by sector specific guidance, following closure of a consultation at the end of 2023.

We expect to see greater clarity with respect to regulating greenwashing as well. In the US, regulators including the SEC have been cracking down on greenwashing and strengthening their rules. In the UK, whilst the Advertising Standards Authority continues to closely police misleading green claims in advertising, we anticipate further guidance from the Competition and Markets Authority arising out of its sector-by-sector review of greenwashing in consumer-facing businesses and many will be closely watching how the Financial Conduct Authority enforces its newly released anti-greenwashing rule and implements its guidance (currently out for consultation) when issued.

Companies wanting to play a role in helping formulate UK ESG policy are invited to participate in various governmental and regulatory consultations, with the key upcoming consultations summarised in Table 1.

UNCERTAINTY

Given the breadth of sustainability, there are still areas of great uncertainty and we expect this theme to continue into 2024, best illustrated by the case of the EU's Corporate Sustainability Due Diligence Directive (**CS3D**).

The directive is ambitious, and in-scope entities need to gear up for its implementation by mapping their value chains and embedding processes into their operations to cater for the level of oversight and assurance that is needed.

There will inevitably be tensions and complexities around how different member states address the directive, and indeed how different players impose requirements across their business relationships. See more detail on the CS3D on page 26.

In the field of ligation, we are continuing to see cases against corporates and financial institutions, and expect this to continue through 2024. For example, the scope of companies' and their boards' duties in an ESG context remains a live issue for companies to watch closely. In 2023, in two separate climate-related derivative claims brought by shareholders against company boards (**ClientEarth v Shell** (in which Slaughter and May acted for Shell and its directors) and **McGaughey v USSL**), the English courts emphasised their reluctance to wade into the reasonable commercial decision-making of boards, even in a climate change context. We expect these issues to play out further in 2024, with boards' ESG strategy and decision-making staying under the spotlight, and that the use of derivative actions will remain in the playbooks of some shareholders with ESG goals.

Elsewhere, we are seeing attempts to **use the courts to** impose direct obligations on companies with respect to their CO2 emissions, such as in the on-going cases *Lliuya v RWE* in Germany and *Milieudefensie v Shell* in the Netherlands. We are yet to see these types of cases before the English courts, where other routes such as threatened **securities claims (sections 90 and 90A/Schedule 10A FSMA)** for misleading statements or omissions in ESG material published by UK listed companies are gaining traction.

Table 1: Key upcoming ESG policy consultations in the UK

Body	Subject matter	Focus of consultation / call for evidence	Status
UK Government	Transition plans disclosures for largest companies	The introduction of requirements for the UK's largest companies (public and private) to disclose their transition plans if they have them, similar to what the FCA is doing (see below).	Was planned to be launched in "Autumn/ Winter 2023" (not yet launched)
UK Government	UK Green Taxonomy	The draft UK Green Taxonomy, designed to be a tool to provide investors with definitions of which economic activities should be labelled as 'green'.	Was planned to be launched in "Autumn 2023" (not yet launched)
FCA	Anti-greenwashing rule	Consultation on the FCA's newly-announced anti-greenwashing rule. **GC23/3: Guidance on the anti-greenwashing rule | FCA**	Closes 26 January 2024
FCA	ISSB	Updating TCFD-aligned disclosure rules for listed companies to refer to UK-endorsed ISSB standards, and the appropriate scope and design for the new regime. New requirements would apply from 2026 (in respect of accounting periods beginning on or after 1 January 2025). The FCA also expect to consult on moving from the current comply-or-explain compliance basis to mandatory disclosures for listed issuers. **Primary Market Bulletin 45 | FCA**	First half of 2024
FCA	Transition plans	Developing guidance setting out the FCA's expectations for listed companies' transition plan disclosures (at the same time as consulting on the ISSB standards). Under the FCA's rules, companies only have to disclose their transition plans if they have one, and this is not expected to change. **Primary Market Bulletin 45 | FCA**	First half of 2024

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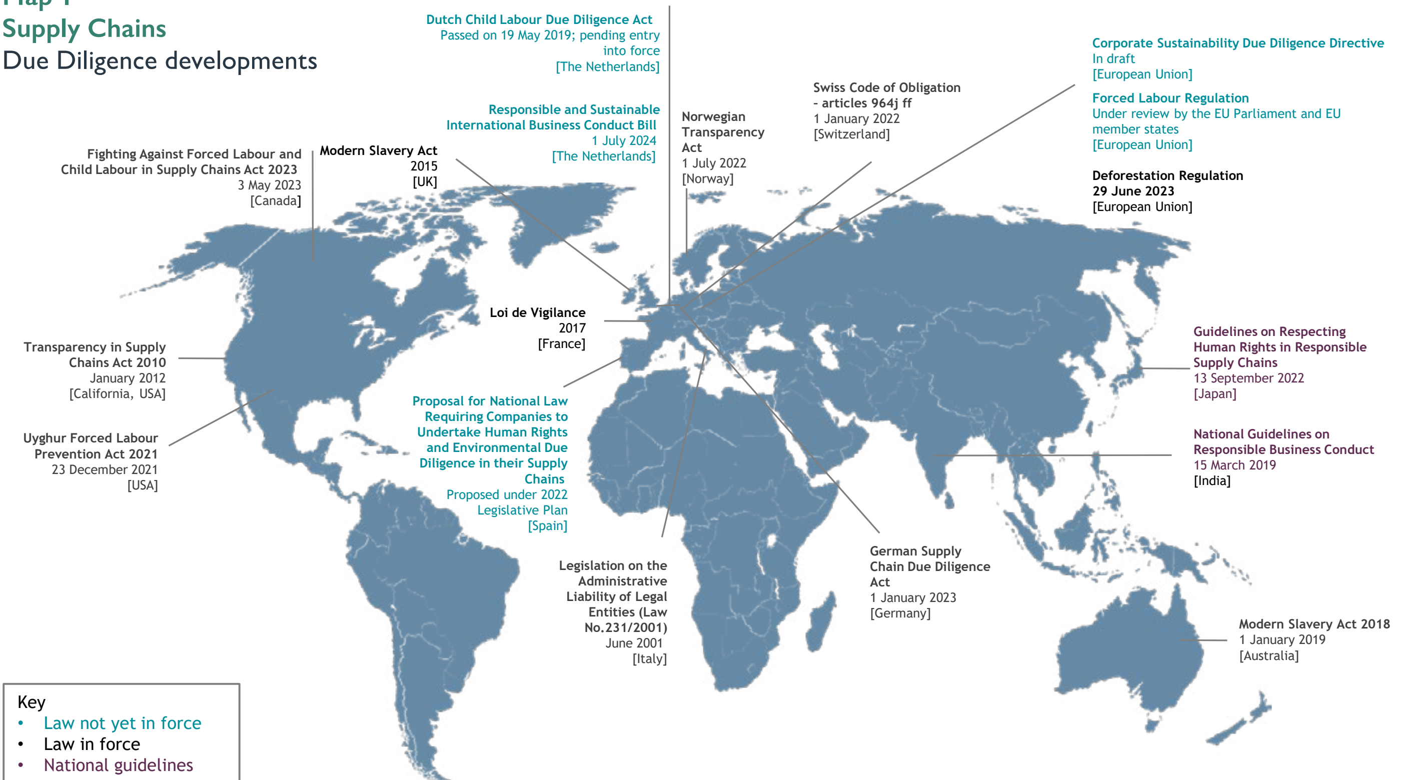
SETTING THE SCENE: BUSINESS AND HUMAN RIGHTS

Human rights have meteorically risen up the corporate sustainability agenda, propelled by stakeholder pressure, civil society and customer expectations of companies, increasing regulation and the risk of litigation. This article discusses the current expectations on businesses to address their human rights impacts, and issues on the horizon.

Human rights: the intersection with business

The requirement for companies to consider the relevance of human rights to their business activities is relatively recent. The 1948 Universal Declaration of Human Rights set the foundation for states' responsibilities to protect and fulfil human rights. It was not until 2011, when the Human Rights Council endorsed the UN Guiding Principles on Business and Human Rights (**UNGPs**), that the expectation for business to respect human rights was formally articulated.

Map 1
Supply Chains
Due Diligence developments



Over time, businesses have recognised that a failure to respect human rights can have significant consequences. In addition to reputational impacts, various mechanisms have been used to hold companies to account, whether through the complaints mechanism under the OECD Guidelines for Multinational Enterprises (**OECD Guidelines**), or through innovative cases brought in the courts. To add to the mix, in recent years there has been an expansion, especially in the EU, of laws requiring companies to undertake human rights and environmental due diligence (**HREDD**) in addition to laws already requiring disclosure of human rights impacts (Map 1).

Moreover, in an increasingly socially conscious society accompanied by social media channels, some companies are marketing their 'good human rights records' to attract customers and obtain financing.

WHAT'S COMING IN 2024?

2024 will be a busy year for businesses and human rights. We expect developments to include:

1. entry into force of the **EU Corporate Sustainability Due Diligence Directive** (**CS3D**) which will require companies to conduct human rights and environmental due diligence following the European Parliament and Council recently reaching a provisional agreement;
2. a greater focus on **corporate disclosures** relating to businesses' human rights impacts, their verification and accuracy in light of underlying processes;
3. further, **deeper integration of human rights considerations in business processes**, such as in supply chain management, due diligence when entering and exiting markets, in M&A activity and in risk management systems (with risk assessment of both the impacts of human rights on the business, and the impact of the business on human rights – the **double materiality approach**);
4. an increased business **focus on the rights of vulnerable or marginalised** people (such as children and indigenous communities), socioeconomic rights (e.g. the right to a living wage) and rights at risk when operating in conflict-affected regions;
5. maturing understanding of companies' **responsibility** for **delivering remedies** for human rights violations associated with their operations;
6. continuing **challenges for multinationals navigating differing ESG approaches** across markets, for example, the US vs. EU approach, and any divergence of the CS3D from the UNGPs and OECD Guidelines;
7. **increased pressure on SMEs** to meet stretching human rights compliance requirements if they are part of the value chain of companies with obligations under the new HREDD laws; and
8. continued **claimant-led litigation** seeking to use (and expand) existing legal mechanisms to hold companies to account for alleged human rights violations.

We deep dive into two of these developments – mandatory human rights due diligence under the CS3D and continued claimant-led litigation – below.

Mandatory human rights due diligence

The CS3D aims to bring about a fundamental shift in corporate responsibility by mandating policies and processes for effective HREDD. This initiative strives to enhance corporate accountability and increase available data on human rights impacts, addressing issues such as child labour, slavery, deforestation and pollution. Prescribed actions will range from establishing a due diligence policy to identifying adverse impacts and taking steps to prevent, cease or remedy them.

Following negotiations between the EU institutions since June, on 14 December 2023, the European Parliament and Council reached a provisional deal on the CS3D. This deal finalises the position on points of disagreement between the EU bodies, but leaves some details to be finalised in the ensuing drafting process. The negotiations were focussed on, among other things, the employee number and turnover thresholds for application, directors' obligations and civil liability. The final text is still to be finalised and formally adopted (expected 2026 or 2027), after which member states will have two years to transpose the CS3D into national law. As always, member state legislatures can add to or strengthen the CS3D in the transposition process, but cannot fall below its standards.

The agreement reached between the European Parliament and Council settles the scope of the CS3D to include large EU companies that have more than 500 employees and a net worldwide turnover of €150 million. Those with over 250 employees and a turnover of more than €40 million will also be in scope if at least €20 million of that turnover is generated in designated high-risk sectors (e.g. textiles, agriculture and mineral trading). Non-EU companies and parent companies with equivalent turnover in the EU will also be in scope but they are expected to have at least three years from the CS3D coming into force to comply. The financial sector will initially be out of scope in respect of their financial services (but in scope in relation to their own operations and upstream activities), subject to a review clause for possible inclusion in future based on an impact

assessment. Companies that are not directly in scope are likely to be impacted by virtue of being in the value chain of an obligated company undertaking its due diligence.

With regard to civil liability, the deal establishes a five-year period for interested parties (including trade unions and civil society organisations) to bring damages claims and caps the cost of proceedings for claimants. Member state supervisory authorities will be empowered to launch investigations, impose fines of up to 5% of the company's net worldwide turnover, implement injunctive measures and to "name and shame" companies that fail to comply.

The CS3D is intended to complement other supply chain diligence instruments, such as the EU Deforestation Regulation and Conflict Minerals Regulation and to cover both human rights and environmental issues, recognising their connected impact. This integrated approach poses a challenge to businesses that are more used to treating environmental and social impacts separately. Methodologies will need to be established: currently, data for climate emissions and diversity are quantitative; human rights, for example, is typically assessed using qualitative data.

Many hope the CS3D will harmonise domestic HREDD laws that have already emerged across some member states. If the finalised directive falls short of stakeholder expectations, companies settling for the lower, regulatory bar may nonetheless face challenge, as may insufficient or inconsistent implementation across EU member states.

Innovative claims based on existing laws

In 2024, we will continue to see claims in England (i) seeking to incrementally expand duties to hold companies to account (e.g. through test cases on the scope and application of tortious and statutory duties to ESG issues); (ii) seeking to test the accuracy, or more likely the inaccurate or misleading nature of disclosures made by corporates; or (iii) brought under foreign law seeking to impose or expand liability for the conduct of corporates, their subsidiaries and suppliers across the globe. Increased public regulatory enforcement action against corporates is likely to fuel this trend.

However, continued attempts to stretch legal boundaries for harm suffered abroad may be tempered by the challenges presented by the post-Brexit jurisdiction rules. Previously, English courts were sometimes required by EU law to hear litigation involving English companies, even where the claims involved foreign subsidiaries, claimants or law, or where the conduct occurred wholly overseas. For newly filed cases, the English courts have reverted to looking to identify the "natural forum" to hear the claim and whether the parties can achieve substantial justice in the jurisdiction with the closest connection to the dispute. We expect to see cases testing the attitude of the English courts given the availability of litigation funding to support such claims. In all such cases, businesses' legal risks may extend beyond English legal duties, to duties imposed by the laws of the countries relevant to their subsidiaries and suppliers.

TAKING ACTION: ADDRESSING THE HUMAN RIGHTS IMPACTS OF YOUR BUSINESS

Early corporate accountability laws, such as the UK's Modern Slavery Act, focussed on driving change through disclosure alone. Increasingly, developing laws (like the CS3D) require corporate action including and based on due diligence.

Seeking advice on how the various laws will apply to an organisation, and then implementing robust internal policies and processes to conduct, report and act on due diligence will be important first steps. Governance processes to monitor progress and escalate issues are essential, as is cross-business coordination to ensure that risk, compliance, legal, procurement, communications, and other teams are consistent in their activities and messaging to minimise risk and scope for claims. Good governance and processes that enable corporates to identify and respond to challenges effectively are likely to provide the best defence.

How a business impacts human rights will vary based on its sector, geography and activities. However, in an increasingly multinational world operating with global value chains and increasing regulation and scrutiny of human rights impacts, now more than ever is the time for businesses to take note and take action.

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SUSTAINABLE FINANCE: LOOKING TO 2024

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The sustainable finance market experienced its first year-on-year contraction in 2022, as inflation, higher borrowing costs, geopolitical tensions and general economic uncertainty depressed activity in most sectors of the debt markets. Although these challenges remained, during 2023 sustainable finance volumes showed signs of recovery. Global sustainable finance issuance totalled $717bn in the first half of 2023 alone, an improvement on the second half of 2022.

Green bonds have been the driving force of this recovery, with global green bond issuance in the first half of 2023 reaching $310bn, the highest half-year total since the inception of the green bond market. Sustainability-linked products have performed less well. Overall volumes of sustainability-linked loans (**SLLs**) and bonds (**SLBs**) have struggled to reach even 2022 levels.

As we enter 2024, there are questions around the future of the sustainable finance market, and perhaps more importantly how the different product categories will fare. Will green bonds continue to dominate? Does the more recent uptick in SLB issuance (in the context of a very quiet year for SLBs) signal good times ahead? Will the upcoming wave of refinancings prompt a surge in SLL volumes? Is an increase in activity the inevitable result of the sustainable finance targets which most of the larger financial institutions have now set for themselves?

Wherever the figures end up in 2024, sustainable finance products and their evolution will remain a key focus area for finance and treasury teams across sectors and jurisdictions, with the flow of legal, regulatory and market developments showing no signs of slowing down. Below we consider some of the developments in sustainable finance to anticipate in 2024.

DEVELOPMENTS IN THE GOVERNANCE AND REGULATION OF SUSTAINABLE FINANCE PRODUCTS

Sustainable finance products have, until recently, been governed exclusively by voluntary recommended guidelines published by the LMA and ICMA.

2023 saw the first step towards more formal regulation of the market with the finalisation of the EU Green Bond Standard (**EU GBS**), a voluntary "gold" standard available to all green bond issuers in and outside Europe which will begin to apply from the end of 2024 at the earliest. There are no immediate plans to adopt a similar standard in the UK or US, but regulators around the world will no doubt be keeping a watchful eye on how far the EU GBS goes to improving the effectiveness, transparency and credibility of the green bond market, not least in the face of questions around its usability and adoption (discussed further in our client briefing **here**).

In the meantime, the debt trade associations are expected to continue to take the lead in the governance of sustainable finance products. The LMA and ICMA will be keeping their voluntary principles under review in the coming year, and each has several supplementary projects in the pipeline to support the growth and integrity of the market.

Increased regulatory scrutiny can, however, be expected. Earlier this year, the UK's FCA **outlined various concerns with the operation and integrity of the SLL market**, stating that it will continue to monitor the market with a view to considering the need for further measures as necessary. In the bond market, it is expected that sustainability disclosure requirements will be introduced for bond prospectuses as part of upcoming UK and EU prospectus regulation reforms, with ESMA having already outlined initial guidance for EU prospectuses.

INCREASED FOCUS ON MITIGATING GREENWASHING RISK

2023 saw a marked increase in greenwashing allegations. While the bulk of these claims have not arisen in a sustainable finance context, the unwavering focus on, and discussion of, greenwashing in a wider sustainability context has brought the risks within the sustainable finance market to the fore.

There is no agreed definition of greenwashing but in a sustainable finance context it typically manifests as the inappropriate use of the green, social or sustainability-linked product label, and can have significant reputational consequences.

Greenwashing concerns amongst sustainable finance market participants tend to manifest in increasing focus from lenders and investors on the materiality of KPIs and ambitiousness of SPTs in a sustainability-linked context, and of the green/social credentials of projects in a "use of proceeds" context, to ensure that ESG labels are being applied appropriately. Contractual protections sought by lenders in SLLs with a view to protecting against greenwashing, for example ESG amendment and declassification provisions, have become more widespread and detailed over the last year. Contractual protections along these lines are expected to evolve further as the market develops.

Mitigating greenwashing risk is, of course, of equal concern to borrowers and issuers. Risk mitigation is predominantly focussed on compliance with the relevant LMA/ICMA voluntary guidelines, which specify robust reporting and external verification processes. Compliance with these reporting and verification requirements requires treasury functions to collaborate with their wider sustainability teams. The upskilling of financing and treasury personnel in relation to the company's ESG strategy, risks and reporting requirements has become a priority for many businesses, both to mitigate greenwashing risks and to ensure that ESG messaging that comes into the public domain is robust and consistent.

INCREASED LENDER AND INVESTOR SCRUTINY AND DUE DILIGENCE

Increased ESG-related due diligence and scrutiny from lenders and investors of the ESG profile of borrowers and issuers has, in recent years, become a feature of all finance transactions (not just those with an ESG label). This is an area that continues to develop, driven in part by evolving reporting requirements (in the UK, the EU and internationally), as well as reputational pressure on the financial sector to lend responsibly and avoid greenwashing (as discussed above). This focus is set to continue into 2024.

Lender/investor due diligence, up until quite recently, has been heavily focussed on climate considerations. More recently (in light of the publication of the final TNFD recommendations) there has been greater focus on nature and biodiversity risks and strategies, and increasing discussion of the need to bring the 'S' and 'G' in ESG to the fore.

On climate-related matters, scope 3 emissions have become a particular focus for lenders and investors, who are increasingly asking borrowers and issuers for disclosures as well as the inclusion of scope 3 emissions targets in a sustainability-linked context. A lack of reliable data has, up to now, hampered many borrowers and issuers, but as reporting requirements expand and data flows improve, an uptick in scope 3-related disclosure and targets is foreseeable in the coming year. In the absence of available data, borrowers and issuers can expect to be put under pressure to indicate the timeframe within which such data will be available.

Increased focus on the role of transition plans in sustainable finance products is also expected in 2024, especially in the UK, following the launch of the Transition Plan Taskforce's Disclosure Framework in October 2023 and ongoing discussion around future legislative/regulatory requirements in relation to transition plans.

Access to financing for those in carbon-intensive sectors has become a key area of contention. Some lenders and investors, faced with overwhelming pressure from stakeholders, have over the course of 2023 adopted increasingly restrictive lending and investment policies with regards to these sectors. Where funding continues to be available, it is frequently conditional on having a robust and credible transition plan in place, a requirement which it seems likely will be extended to further sectors in the coming year.

The impact of ongoing work to regulate ESG rating providers, both at UK and EU level, on lender/investor due diligence also remains an area to watch in 2024, although it seems most likely that, if anything, ESG ratings will simply serve to supplement rather than replace existing due diligence processes.

DEVELOPMENTS IN THE STRUCTURE AND TERMS OF SUSTAINABILITY-LINKED PRODUCTS

The SLL and SLB products are conceptually accessible to a wider range of borrowers and issuers when compared to "use of proceeds" products, but this has not translated into volumes of sustainability-linked products (SLBs in particular). The 2023 recovery of SLL/SLB activity has been significantly weaker than, for example, the green bond market.

Faced with the same macro-economic and political headwinds, it is clear that the sustainability-linked market is facing deeper-rooted challenges which need to be addressed to facilitate further uptake and growth.

Nervousness from lenders, investors and regulators around the credibility of the asset class, particularly SLBs, has contributed to the reduction in volumes. The debt trade associations have sought to address this challenge through updates to their principles and accompanying guidance in 2023.

Reticence to issue sustainability-linked products currently appears more apparent on the borrower and issuer side. Sustainability-linked products, considered by early movers as an effective way for businesses to demonstrate their commitment to sustainability, may now not be viewed as critical, with wider corporate sustainability strategies and disclosures adequately fulfilling this role.

This is against the backdrop of very thin economic incentives to adopt sustainability-linked structures. As identified by the UK's FCA as part of its review of the SLL market mentioned above, the economic incentive structure for sustainability-linked products is weak, with margin discounts minimal (and increasingly so as a proportion of now higher borrowing costs).

This, coupled with the increasingly stringent reporting and verification requirements involved in sustainability-linked structures laid down in the latest LMA/ICMA principles (which no one disputes are important in protecting the integrity of the market but no doubt impose a greater burden on borrowers and issuers) and the extra scrutiny and greenwashing risk that comes with issuing a sustainability-linked product, and the calculation for borrowers and issuers is perhaps no longer what it was. Whether a reassessment of the incentive structure (in particular in the leveraged and other sectors of the loan market where relationship pricing is less apparent) might tip the balance for borrowers and issuers is a question that many have started to ask.

In addition to the incentive structure, the terms of sustainability-linked products, which are still relatively new and untested, have also been under the spotlight in 2023 to ensure they provide necessary levels of protection to lenders and investors (see the discussion on greenwashing above) as well as supporting the integrity of the wider market. ICMA recently added to its SLB guidance in this regard and, in May 2023, the LMA published template drafting for SLLs which addresses a number of these concerns. SLL and SLB terms will continue to evolve in 2024, with the direction of travel towards greater detail and complexity.

With sustainable finance now an established feature of the debt markets, the question of whether and how best to engage with the products available has become a question that is routinely considered by all market participants. 2023 was a testing year overall for the sustainable finance market. While there are some signs of recovery, aggregate volumes of sustainable financing mask an interesting dynamic at play, one in which green bonds have dominated and sustainability-linked products have lagged behind. Under pressure to increase volumes, we expect that lenders and investors will take steps to respond to product-specific challenges, supported and driven by efforts from governments, regulators and industry bodies, in recognition of the key role sustainable finance has been designated in advancing the wider sustainability agenda.

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INVESTING IN TRANSITION INFRASTRUCTURE

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SIGNIFICANT INFRASTRUCTURE INVESTMENT IS REQUIRED

Infrastructure is at the heart of the energy transition and efforts to decarbonise global economies. Existing building stock, transport systems and energy infrastructure need to transform alongside developing new types of assets such as CO2 transport and storage networks and battery gigafactories. Associated, enabling infrastructure is also needed, such as new port facilities capable of servicing the deployment of significant volumes of offshore wind generation.

In order to reduce emissions by 45% by 2030 and hold global warming at 1.5°C, investment in energy transition infrastructure is key. Significant injections of capital are not only essential for the repurposing of existing systems and networks, but also for the development of a whole new range of clean infrastructure assets.

However, whilst investment in infrastructure is steadily increasing every year, it needs to accelerate at pace. The International Energy Agency (IEA) has warned that "a substantial ramp up" in investment is called for, whilst the Energy Transitions Commission (an international coalition of NGOs, financial institutions and industry leaders) estimates that a global net zero economy requires an average of $3.5 trillion capital investment a year to 2050.

WHERE AND WHAT?

The positive momentum behind infrastructure investment, and clean energy investment in particular, is not distributed evenly across countries or sectors. In a 2023 survey of its members, the Global Infrastructure Investment Association found that, in terms of acquired assets, transactions continue to be centred around Western markets, with the US, UK and EU accounting for 74% of acquisitions in 2021 and 2022, albeit with growth in other regions. Meanwhile clean energy spending is heavily concentrated in China, EU and the US, although, according to the IEA World Energy Investment Report 2023, investor activity is increasing in India, Brazil and parts of the Middle East.

With regard to sectors, the IEA **World Energy Outlook 2023** has identified a focus of activity on areas linked to clean electrification and end-use electrification, whilst investment in energy efficiency and low-emission fuels fall short. Mature clean technologies such as wind, solar, and battery storage are seen as cost-competitive in today's fuel-price environment. However, in the offshore wind sub-sector, we have seen some market participants and projects adversely affected by increases in development costs. In its **World Investment Report 2023**, the UN Conference on Trade and Development noted a requirement for investment not just in renewable energy but also in supply chains including R&D activities, critical minerals extraction and in manufacturing of solar panels and wind turbines. The IEA also reports a growing momentum for investment in newer technologies such as low carbon hydrogen and carbon capture, utilisation and storage (**CCUS**).

Other key elements of energy transition infrastructure such as power grids have seen much less growth. Grids – often publicly owned or highly regulated assets – have struggled to secure funds for anticipatory investment due to consumer-cost concerns, but a sea-change is underway due to the electrification requirements of the energy transition. The **International Renewable Energy Agency** also observed a "chronic lack of investment" in end use applications in other areas of the energy ecosystem – including heating and transport – as well as other energy transition technologies such as biofuels, geothermal and hydropower.

WHAT ARE THE CHALLENGES AND HOW CAN THEY BE MANAGED?

Geopolitical tensions, supply chain constraints, shortages in skilled labour, inflationary pressures and higher interest rates are all factors putting pressure on infrastructure investments. These macro-economic challenges may be exacerbated by sector-specific headwinds such as political risk, or immature regulatory frameworks and standards.

For example, investors in critical minerals must increasingly navigate issues of social justice and the need to find the appropriate balance of resources and returns between international and local stakeholders. Regulatory change or divergence in approaches between markets may pose a further barrier to investment. For instance, in relation to hydrogen production, the absence of an internationally recognised standard means that investors are increasingly faced with a jigsaw puzzle of national or regional definitions and standards for low carbon hydrogen. In the EU organisations are also increasingly reporting by reference to the EU taxonomy defining sustainable economic activities. However, the UK equivalent taxonomy is still under development meaning that any differences in approach are likely to place additional reporting requirements on investment managers.

Some of these challenges may be able to be mitigated or minimised. In some jurisdictions, where legislators understand and accept investor concerns, the regulatory regime itself may be designed to reduce risks to investors. Absent this, contractual risk management strategies may be used appropriately to allocate risks (albeit for a price) or to provide flexibility for the contract to continue in the event of a change in law. Finally, transaction structuring may also serve to mitigate key risks, such as having a key supplier, offtaker or government as a minority equity partner to reduce the risk of termination of long-term arrangements underpinning the investment.

TRENDS IN INVESTMENT IN ENERGY TRANSITION INFRASTRUCTURE

In order to reach the level of investment needed, different pools of capital are required to invest in decarbonisation and energy transition projects. As a result, we are seeing new dynamics emerge in the infrastructure investment landscape.

New clean technologies may be difficult for some investors who lack the mandate to invest until technology has matured or greater deployment has occurred, with the associated learnings and cost reductions that this brings. However, in sectors such as low carbon hydrogen and CCUS we are seeing the entry of both small-scale private capital and large-scale industry-funded capital. Traditionally, funds and institutional capital typically step in later after construction when assets are being de-risked. Yet we are seeing exceptions: certain institutional funds are taking on roles more akin to venture capital, investing in assets outside their existing portfolio profiles in order to learn about specific sectors or technologies and associated risks.

Government support schemes are also being designed with different types of capital and risk appetites in mind. For example, the USA's Inflation Reduction Act uses a high level of subsidy via tax credits to attract developers and private investors into energy transition infrastructure. By contrast, in the UK, we are seeing an increase in the use of the Regulated Asset Base models in assets such as new nuclear power, hydrogen pipeline networks and carbon dioxide transport and storage networks, providing stable, regulated returns for investors.

Certain changes to the regulatory treatment and capital requirements for insurers are also playing a role. Solvency UK, the prudential regulatory framework for insurers and reinsurers, is intended to facilitate infrastructure investment by UK insurers, due to recent and upcoming changes which it is hoped will encourage investment in sectors such as low carbon energy generation and energy networks.

WHAT ARE THE SHIFTS EXPECTED IN 2024?

In 2024, we anticipate energy transition infrastructure will continue to be a strong and resilient asset class in a broad range of sectors and markets. We expect to see new opportunities for investors as governments increasingly align their policies and budgets with their climate commitments. In a competitive global capital landscape, policy makers will be working hard to foster a positive investment environment fit for a net zero future.

There is likely to be increasing competition for mature assets and infrastructure targets, whilst newer technologies and markets would benefit from more investment looking to test value propositions before deciding whether to scale up. With global economies seeking to plug the considerable gaps in energy transition supply chains, investors may be revisiting their portfolios to identify where long-term returns are most likely. This may result in greater investment into more developing markets if the right conditions for growth exist.

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SPOTLIGHT ON THE ROLE OF HYDROGEN AND CARBON CAPTURE IN CORPORATE DECARBONISATION

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DECARBONISATION AS A BOARDROOM AGENDA ITEM

Intergovernmental agreements and national decarbonisation targets are translating into regulation aimed at requiring decarbonisation across the global economy. In the UK and EU, measures impacting business range from sustainability disclosures, transition plans and supply chain scrutiny to national or regional carbon pricing, and carbon border taxes.

But the drivers to decarbonise are not just regulatory. Customers, investors and lenders are increasingly conscious of the environmental and social impact of their activities. And businesses themselves are also increasingly reassessing their purpose and viewing their ESG strategy as a way to drive value and to attract the best talent. 2024 will continue to see the corporate world seeking solutions to become more sustainable.

ENERGY PROCUREMENT STRATEGY IS AT THE HEART OF DECARBONISATION PLANS

Decarbonisation is primarily an energy issue. As a result, deploying energy efficiency measures, electrifying sectors of the business - for example moving to a fleet of electric vehicles - and switching to a pure renewable energy supply are a key part of many decarbonisation strategies.

Procuring renewable power can be done in a number of ways. Many organisations opt to buy power using green tariffs. However, in the UK for example, the rules which allow the use of renewable energy guarantees of origin to be used by suppliers of green tariffs to "green" fossil

fuel-derived power are coming under increasing criticism. As a result, organisations are increasingly opting to pursue direct procurement strategies, such as corporate renewable power purchase agreements (**CPPAs**). We expect interventions by governments and regulators focused on encouraging the further use of CPPAs in some markets: for example the EU's third Renewable Energy Directive (**RED III**), approved in autumn 2023, aims to address some of the barriers to CPPAs.

TACKLING EMISSIONS THAT ARE HARD TO ELECTRIFY

Where electrification is not feasible, businesses are increasingly considering carbon capture, usage and storage, low carbon hydrogen and derivative fuels as part of their decarbonisation strategy. This is particularly relevant for sectors which are hard to electrify such as aviation, shipping, heavy goods transportation, and in industrial processes such as steel, cement and chemicals production. Data from the International Energy Agency in 2019 estimates that these sectors account for around 30% of global CO2 emissions.

Carbon capture technology is an established, multi-use technology

Carbon capture technology can be applied to facilities to ensure that most of the carbon emitted is captured and permanently stored using carbon dioxide transportation and storage networks (**CO2 T&S networks**). In markets exposed to carbon pricing or where a carbon border tax applies to exported goods, the avoidance of carbon costs can be a significant driver for investment. CCUS can also be used to remove CO2 from the atmosphere – a process known as Direct Air Capture – resulting in emissions reductions, generating carbon offsets. However, despite being a proven technology, deployment of carbon capture at scale to date has been limited, and costs remain high.

A significant barrier to investment is the availability of, and reliance on CO2 T&S networks. They are key for the success of a carbon capture project – if the network is delayed or suffers an outage, the captured carbon must be vented, exposing the capture business to carbon costs and, in the event of prolonged outages, a stranded asset. These networks are not generally established yet, meaning businesses seeking to deploy carbon capture technology will also need to assess the deliverability of the CO2 T&S network.

As a result, carbon cost avoidance may not be sufficient incentive for investment. Some governments, such as the UK, are seeking to intervene via support packages for initial projects offering both financial incentives and mitigation of co-dependency risks. Other jurisdictions, such as the USA, leave CO2 T&S network risks to be managed between project developers, but offer more generous subsidies to compensate firms for the higher level of risk involved.

The role of hydrogen is still emerging but is gaining traction

Today, around 98% of the hydrogen produced is derived from fossil-fuels with the resulting carbon dioxide emissions being released into the atmosphere. This fossil-fuel derived hydrogen is used primarily in industry (e.g., refining, chemicals and steel) and represented around 2.5% of global energy-related carbon emissions in 2019. By contrast low carbon hydrogen can be made using a number of methods including by capturing the emissions from natural gas-derived production (known as blue hydrogen). Another method uses electrolysis of water using renewable or low carbon electricity (known as green hydrogen). As well as displacing the use of existing fossil-fuel derived hydrogen, low carbon hydrogen is also seen as a replacement for natural gas in heavy industry or as a fuel more generally. When combined with recycled carbon, it may also be used in the production of drop-in, synthetic fuels, which has the potential to decarbonise aviation and shipping.

Production of and demand for low carbon hydrogen is expected to grow in the coming years. In the EU, demand is expected to be stimulated by RED III which sets a target of 60% of hydrogen used in industry to be from renewable fuels of non-biological origin by 2035 and a target of 29% of fuel used in transport to be renewable transport fuels by 2030. The UK is targeting 10 GW of low carbon hydrogen production by 2030.

We are already seeing a scale up of low carbon hydrogen production. Regions like Australia, Africa and the Middle East are gearing up to become net exporters: for example, Slaughter and May are advising on a multi-billion US$ green hydrogen project between the Republic of Namibia and Hyphen Hydrogen Energy. This project is geared towards exports. In the longer-term, we expect to see the development of an international hydrogen market. Distinct import markets are already emerging. For example, Germany and Japan are expected to be net importers of hydrogen: Germany has pioneered H2Global, an organisation that aims to support hydrogen imports.

MAKING THE BUSINESS CASE FOR INVESTMENT

Whilst there are risks associated with early investment in new sectors, there are government support schemes which can make these investments a viable option for corporates' decarbonisation strategies. The UK government, for instance, offers broad support, ranging from grants for development activities, to capex and operating support. These are available to companies producing low carbon hydrogen, as well as companies seeking to introduce carbon capture technology in their operations. For example, in December 2023, the first hydrogen allocation round has seen 125MW of electrolytic hydrogen production awarded £2bn of revenue support.

The EU is also incentivising decarbonisation using green hydrogen. It is aiming to reduce the price gap between renewable and fossil-fuel derived hydrogen, reducing risk

for entrants and stimulating the formation of a market with the launch of the European Hydrogen Bank. The first pilot auction opened in November 2023, which is expected to allocate support to renewable producers located in the European Economic Area in the form of a fixed premium per kilogram of hydrogen produced. H2Global (which has recently joined forces with the European Hydrogen Bank) is facilitating green hydrogen imports into the EU, pioneering a central buyer model and acting as an intermediary between producers who require long-term offtake agreements, and buyers who prefer short-term contracts.

Initiatives are also underway to ensure finance is available to projects, despite their novelty. For example, UK Infrastructure Bank has a mandate to provide financing solutions (e.g., credit enhancements, senior debt and senior debt guarantees) to enable the government to meet its ambition to build four CCUS clusters, capturing 20-30 million tonnes of CO_2 per year by 2030. A similar fund has recently been launched in Canada, the Canadian Growth Fund.

KEY TAKEAWAYS

CCUS, hydrogen and e-fuels are expected to play an important role in decarbonisation strategies in 2024 and beyond. The drivers to decarbonise mean that challenges to investment must be addressed, whether in regulation, via government support or via commercial agreement. Those interested in investing in these innovative schemes will need to evaluate their decarbonisation pathways, assess what government support is available and stay ahead of shifting regulatory regimes.

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SLAUGHTER AND MAY
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THE POTENTIAL OF HYDROGEN
A GUIDE TO KEY EUROPEAN MARKETS

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DIGITAL

The rate of change in the technology and digital landscape shows no signs of slowing in 2024. While this environment makes it difficult for legislatures to keep pace, the global drive to regulate means that existing laws are evolving, new rules are being agreed and 'soft regulation' (standards, guidance etc.) are more important than ever.

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AI

The race to establish innovation friendly AI regulation in a globally competitive market continues, with the UK, EU, US and China all active in this space. Existing laws are being tested in the courts and new legislation and guidance is expected in 2024. International co-operation, or at least discussion, around the common risks AI creates, looks set to continue. The UK hosted the inaugural global AI Safety Summit in November 2023, bringing together world leaders, technology companies and AI experts. More summits are planned for 2024, as are AI discussions at the G7 and G20 level.

EUROPEAN TECH M&A RESILIENT, ALTHOUGH VC INVESTMENT STILL CHALLENGING

The European tech sector was not immune from challenging market conditions in 2023, although M&A activity remained at comparable levels to 2022 fuelled in particular by digital infrastructure transactions. Acquirers continue to see opportunities to deliver value, often with more structured deals to mitigate potential downside. VC investment has been challenging, although again funding is still there for the right companies, with earlier-stage investment still being seen in particular across the AI, FinTech, ClimateTech and HealthTech sectors. We expect these trends to continue into 2024, with the possibility of a "bounceback" later in the year as more capital becomes available and valuation gaps further close.

CYBER

Ransomware attacks show no signs of slowing and supply chain attacks continue to cause concern, with a number of high profile cases hitting the news in 2023. Looking forward into 2024, it is vital to stay across the changing threat landscape, from a regulatory, technical, and geopolitical perspective. Digital transformation and AI adoption can increase cyber risks, new cyber laws (e.g. NIS2, SEC rules) are impacting a wider number of organisations and state-aligned actors are an emerging threat in sectors linked to critical infrastructure.

DIGITAL INNOVATION IMPACTS ALL AREAS

Are existing laws fit for purpose in a digital age? The rate of technological development across AI, quantum, Web4, IoT etc. is making it difficult for regulators to keep pace. Multiple new legislative proposals also raise concerns around 'regulation fatigue' as organisations struggle to cope with an increasingly complex web of rules and guidance. These new rules often overlap, and are sometimes inconsistent. Moving in to 2024, the need for regulatory coordination is clear, and it is hoped initiatives such as the DRCF's new pilot advisory service will help.

TECH LEADING THE ESG AGENDA

'Greenwashing' and other climate change litigation claims have led to material legal, reputational and financial repercussions for global tech companies. The reporting landscape has become increasingly complex for tech companies, with a greater volume and sophistication of ESG related reporting legislation. European regulators are at the forefront of this drive.

BIG TECH V ANTITRUST

European antitrust agencies are taking a leading role in global interventionism against Big Tech, and agencies worldwide are stepping up efforts to cooperate with each other. Concerns around killer acquisitions impacting innovation are driving expansive approaches to jurisdiction and new merger control notification requirements, and agencies are increasingly ready to intervene in transactions on the basis of complex theories of harm across vertical or adjacent markets. Antitrust agencies are proactively monitoring new and evolving tech markets to identify potential future competition concerns.

DIGITAL TRANSFORMATION

In order to compete and meet customer needs, companies are pivoting away from old processes and embracing new technologies. This brings opportunities - to enter new markets, attract new customers, commercialise data, increase efficiencies etc. However, transformation projects carry operational, reputational and regulatory risk, and when things go wrong the impact can be far reaching. Maintaining operational resilience is key, particularly in regulated sectors. Extensions to the reach of financial regulators over critical third parties (e.g. IT providers) in both the UK and EU demonstrate the regulatory focus in this area. Good governance and risk management is also vital.

CRYPTO AND SMART CONTRACTS

2024 will ring in a new approach to cryptoassets in the UK, as the government lays secondary legislation to bring a broader range of cryptoasset activities within scope of the regulatory perimeter. In parallel the EU's standalone cryptoasset legislation, the Markets in Crypto Assets Regulation (MiCA), will start to take effect from late June (with full application from December 2024, subject to transitional provision). Meanwhile, conversations on the viability of a retail central bank digital currency have progressed beyond initial exploration in both the UK and EU.

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ACTIVISM

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WHAT WERE THE KEY TRENDS AND HOT TOPICS IN 2023?

Over the last few years, we've seen overall activism levels rebound to pre-pandemic highs and a period of sustained intensity globally, despite continued market volatility and uncertain macroeconomic conditions. Activity in Europe, and the UK especially, continues to increase exponentially – with 2023 set to be another record-breaking year. Campaigns against European companies accounted for over a third of all global activity in 2023, with UK companies representing over half of the European targets; meanwhile in the US, there was a dampening of activity levels, with US campaigns accounting for just around 40% of global campaigns for the first time.[1] A recent trend has been increased targeting of the "mega caps" – and this has been a notable feature in the UK, with campaigns against GSK and Prudential, for example.

While activism is becoming a more permanent feature of UK listed company life, the activism landscape and the tactics deployed by activists continue to evolve.

The household name activists remained very active in 2023 – with Elliott again topping the chart with 11 major campaigns launched globally – but the universe of activist players is expanding and the boundary between "activism" and "active stewardship" is blurring, in particular with traditional institutions becoming more active themselves or prepared to side with activists as an impetus for broader change. Non-core activists accounted for around 83% of campaigns in the UK – and we continue to see first time activists and spin offs from existing players enter the fray.

Despite the challenging market conditions, M&A remained the dominant activist demand - especially in Europe where almost 60% of campaigns had an M&A angle. However, this has been driven by increased calls for break-ups and divestures as a means to unlock depressed valuations, rather than calls for full company sales or "bumpitrage" given public takeover activity remains at historically low levels.

Activists are also continuing to push for Board representation and pursuing a wide range of governance objectives, either standalone or as a means of reinforcing a narrative of management underperformance to support an overarching strategic thesis. The activist-friendly UK legal framework, including relatively low thresholds for shareholder rights and requirements for annual director re-election and "say on pay" votes – coupled with increased Board accountability, as institutional investors, the FRC and ever-influential proxy advisors look to monitor compliance with the Corporate Governance Code and the quality of market disclosures – has contributed to an increased public agitation and requisitions for shareholder meetings/resolutions.

[1] Source: All data is sourced from Bloomberg market data to end Q3 2023

WHAT CAN COMPANIES EXPECT FOR 2024?

Looking ahead, we expect activity in Europe to continue to intensify, and for UK companies to remain the key targets, given the challenging market conditions, lower share price valuations and activist-friendly legal and corporate governance environment.

We expect that that the spectrum of activist investors will continue to broaden and that their playbooks will keep evolving. Over the last few years, along with leveraging their legal rights, activist investors have deployed tactics such as privately engaging with other shareholders, hiring external consultants to make recommendations, publishing open letters and using social media and microsites to bolster their campaigns. We have seen more mainstream institutional investors becoming activists in their own right – mostly through private engagement with companies so far – but we expect that to continue in 2024. We may also see more campaigns launched by first-time activists or spin offs from established players, whose playbook can be more difficult to predict.

While specific campaign objectives will again be driven by market developments, the fundamental themes of M&A, governance change and ESG will remain high on the activist agenda. For example, if M&A activity re-gains pace, we may see a return of activists taking stakes to try and sweeten announced deals or more active calls for major spin-offs. And it remains to be seen whether increasingly mandatory ESG reporting requirements will reduce the number of ESG-driven requisitions or provide more levers for shareholders to use to hold companies to account.

We are also starting to see signs that US-style settlement agreements and activists requisitioning their own board representation may become more of a feature of the UK landscape than it has been to date, so that may be a growing trend in 2024.

WHAT SHOULD COMPANIES DO TO PREPARE?

The key point to remember is that most activists are ultimately seeking a return over the short to medium term – and so will be looking for an actionable corporate event that can deliver that. So it is important for companies to think like an activist and ask themselves what that actionable step or attack theme might be and, importantly, what the company would say to rebut that challenge. Having done that exercise, companies should be proactively engaging with shareholders to ensure they understand and are bought-in to the strategy. That will help to minimise the risk of institutional shareholders, who are becoming increasingly active, siding with an activist or using a live public situation as a catalyst to voice broader discontentment with management on strategy. Companies should also seek to maintain Board and management consensus on strategy – and be live to the risk of activists seeking to exploit potential divisions.

On a more practical level, companies should be well-briefed on the legal tools available to activists and regularly monitor the shareholder register to spot signs of potential stakebuilding.

As the activism landscape continues to evolve and new players and tactics emerge, advice on how different types of activist operate and how best to plan for and respond to the full spectrum of activist situations will be invaluable.

We act for more FTSE listed clients than any other law firm and regularly advise company boards and management teams on situations ranging from private engagement to public campaigns and requisitions, as well as M&A arbitrage and takeover bid defence. You can read more here.

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SECURITIES LITIGATION

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Securities litigation, long established in the US, is now an increasing risk for UK listed companies and their boards, driven in particular by a flourishing litigation funding market. The need for corporates to carefully consider the content and timing of their market announcements has never been greater.

The Financial Services and Markets Act 2000 (**FSMA**) gives investors in listed companies a right to seek compensation for losses caused by a company's failure to provide full, accurate and timely disclosure of matters relating to its securities. The regime differentiates between misleading statements and/or material omissions in prospectuses and those in other market announcements.

- Section 90, FSMA imposes liability on companies and their directors for misleading statements and omissions in a prospectus. It is a defence for a company and its directors to show that they were not negligent in the preparation of the prospectus. An investor does not need to show that they relied on the prospectus when acquiring shares. This is the closest UK law comes to the fraud on the market theory which underpins many US securities law actions.
- Section 90A and Schedule 10A, FSMA creates a similar, but significantly less claimant-friendly, regime for other market announcements. It only bites where the relevant misstatement or omission was made knowingly or recklessly by a person discharging management responsibility (i.e. a director) and was relied upon by an investor. Only the company (and not associated persons) can be made liable.

Relatively rare until recently, there are now a growing number of section 90 and 90A claims. Many arise from regulatory settlements entered into by companies with enforcement authorities (in particular the Serious Fraud Office). Examples currently making their way through the courts include G4S (a trial to determine liability is scheduled for Q1 2024; reliance, causation and quantum will be decided later), Glencore and Petrofac. Nearly all are brought by groups of claimants, sometimes very large. It is the resulting prospect of very significant damages awards that makes this kind of litigation attractive to professional litigation funders.

However, there remain significant questions as to the proper meaning and effect of sections 90 and 90A/schedule 10A. No large-scale section 90 case has ever reached trial and there is only one judgment on section 90A: Autonomy v Lynch, handed down in 2022. And that was an unusual case on its facts which has left open critical issues, including on the question of reliance. A judgment on quantum in that case is still awaited.

Procedurally, too, there have been difficulties for would-be claimants. England has no equivalent of the US federal regime for opt-out class actions brought under securities laws. Up to now, claimant law firms and funders have had to build a book of prospective claimants before starting litigation. After proving a misleading statement was made, they have been required (in the case of schedule 10A claims) to show that each claimant relied on the misstatement in trading in shares and, in all cases, that the relevant statement caused loss to the claimant. The last two stages in particular can be legally and factually challenging, all the more so when the group of claimants is large.

A novel claimant tactic would short-circuit this process by splitting proceedings in two: in the first stage, one investor, as representative of all other investors in the same position, asks the court for a declaration that a misleading statement or omission was made. The class of investors are not active participants in this claim, indeed they need not even be aware of it. All that is required is that they be identifiable as a class. If the court finds there was a misleading statement, members of the class may, if they choose, rely on that finding to bring claims for compensation against the company.

For claimants, the major benefit of this bifurcated approach is that they need only engage with the process once it is clear that there is a factual basis for a claim. Conversely, the burden of resisting proceedings falls immediately upon defendant companies, at a time when the size of any later damages claim may be unclear. Unsurprisingly, defendants have argued this it is unfair and have challenged the use of the representative claimant model in securities law claims. In November 2023, Reckitt Benckiser and Indivior, defendants to related section 90/90A claims, succeeded in having representative claims struck out by the High Court. It remains to be seen whether that decision will be appealed and/or whether it is applied in the other representative claims started over the course of 2023.

In the meantime, funders and claimant firms continue to explore potential securities claims against listed firms, and there is increasing evidence of claims outside the established playbook of piggy-backing off regulatory settlements. Greater emphases on sustainability reporting and ESG will present a rich stream for funders and claimant firms to mine, and there are signs that their attention is already moving away from a sole focus on governance issues towards claims founded on market statements in respect of firms' environment and social credentials, including adherence to human rights and supply chain standards.

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COMPETITION AND CONSUMER LAW ENFORCEMENT

Recent years have seen an uptick in competition and consumer law enforcement. As authorities grapple with major economic developments like digitalisation, sustainability, and the cost-of-living crisis, their interventionism has increased. This trend will continue in 2024.

Tim Blanchard
Partner

DIGITAL ENFORCEMENT AND REGULATION

Many competition authorities worldwide have focused their recent attention on the digital sector given its importance to the economy and society at large. In addition to the numerous competition probes into digital markets around the world, several jurisdictions have introduced ex ante regulation to address potential competition concerns in this space. In the EU, the six 'gatekeepers' designated under the Digital Markets Act have until March 2024 to ensure full compliance with their new obligations. In the UK, the Digital Markets, Competition and Consumers Bill (DMCC Bill) is expected to become law in 2024. The Bill will introduce a new regulatory regime for undertakings designated as having strategic market status in respect of a digital activity.

This focus on the digital sector is likely to continue for the foreseeable future. In November 2023, the G7 competition authorities issued a communiqué noting that they will continue to act in this area by enforcing competition laws, improving the existing regulatory toolboxes, and developing new regulatory frameworks.

CARTELS AND LENIENCY

Antitrust enforcement across the wider economy also remains at the top of the agenda for competition authorities.

Cartels are a particular focus area. Several competition authorities developed new procedures and technologies in response to a decline in parties seeking leniency for participation in cartel conduct. The UK's Competition and Markets Authority (CMA) and the French competition authority, for example, have noted that around half of their cartel investigations are now based on alternative sources such as individual whistle-blowers. Similarly, the Spanish competition authority uses AI tools to assess the competitiveness of public tenders.

These developments have helped reverse the decline in voluntary applications. The head of the European Commission (EC) cartel directorate recently noted that the agency had received a double-digit spike in immunity/leniency applications in 2023, following a twofold increase in 2022 of the applications received in 2021.

There has also been a strong resurgence of dawn raids across various sectors, particularly following the COVID-19 pandemic. Authorities are increasingly focussed on accessing and seizing electronic data, including server-based data that

is located outside of the premises being raided. These factors, combined with the rise of home or remote working and the use of personal devices for work, create new challenges for companies subject to dawn raids. In this environment, competition compliance and dawn raid preparedness should remain high on a company's legal agenda for 2024.

NOVEL AREAS OF INVESTIGATION

In addition to traditional concerns around prices and market allocation, competition authorities are probing novel areas of conduct as part of their enforcement efforts. A particularly hot topic at the moment is **labour** markets. The CMA, for example, highlighted this as an area for enforcement action in its **Annual Plan for 2023-2024**. They issued guidance noting that anti-competitive collusion between employers is illegal and can lead to "significant financial and personal consequences".

European competition authorities are also prioritising this area. Recent examples include investigations into no poach agreements (Portugal); wage fixing agreements (Poland) and information exchange (Lithuania). The EC has also given a clear **indication** that it is looking to investigate anti-competitive conduct in labour markets, as well as potential cartels in respect of other non-traditional areas such as purchasing or technical innovation.

These more novel areas of investigation should serve as a prompt for companies to take a fresh look at their compliance policies and consider whether training should be rolled out to additional parts of the business such as the HR, purchasing and R&D teams.

SUSTAINABILITY

Many businesses around the world are taking unilateral action to address sustainability challenges. However, it is recognised that cooperation is, and will be, necessary to deliver paradigm shifts in some areas. This need for multilateral action has seen several competition authorities issue guidance in relation to sustainability cooperation.

However, the law is still developing and there are diverging approaches between authorities. For example, both the **CMA** and the **EC** issued the final version of their guidance in this area in 2023. A key point of divergence is the extent to which, when assessing whether an exemption may apply for potentially anti-competitive agreements, consumers of the relevant products or services must be fully compensated for any competition harm or whether the sustainability benefits accruing to different consumer groups can be considered. In a break from the EC, the CMA is willing to consider wider benefits to the society for agreements which contribute to combating climate change.

These divergences mean that businesses considering sustainability initiatives which may restrict competition should ensure that they meet the conditions for exemption in all relevant competition regimes.

COST-OF-LIVING AND CONSUMER PROTECTION

Competition authorities are also focussed on the effects of the cost-of-living crisis. The CMA, for example, has carried out recent studies in several consumer facing areas, including groceries, housebuilding, rented accommodation, road fuel and vets. There have also been calls for investigations in response to the cost-of-living crisis in several other European countries, including Belgium, Norway and Spain. The EC has noted that the cost-of-living crisis is an enforcement priority with cases in the pharma, basic industries and consumer goods sectors.

In addition to competition law enforcement, we can expect to see greater consumer protection enforcement activity in the future. In the UK, for example, the CMA has been increasingly active in the consumer protection space in recent years. The DMCC Bill will give the CMA significant **new consumer protection enforcement powers**. Central to this is the introduction of an 'administrative enforcement model', whereby the CMA will have the power to issue infringement decisions for consumer law breaches. Most importantly it will enable the CMA to directly impose fines of up to 10% of an undertaking's global turnover. This legislation firmly establishes consumer law as a key enforcement priority for the CMA. Companies should expect to see the authority using its new arsenal of investigative and enforcement tools soon.

At the EU level, the Consumer Protection Cooperation (**CPC**) network process is a cross-jurisdiction mechanism aimed at streamlining consumer enforcement via coordinated action. The 'external alert' tool allows designated entities to submit complaints to the CPC network and the EC about business practices that may infringe consumer protection law. The recent use of the tool in respect of alleged 'greenwashing' claims may be a sign of more action to come in this area.

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COLLECTIVE PROCEEDINGS: EMERGING TRENDS

The UK collective actions regime for competition damages actions has developed rapidly since the Supreme Court handed down its landmark decision in *Merricks v Mastercard* in December 2020. More companies can expect collective proceedings for abuse of dominance claims in 2024.

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LEGAL FRAMEWORK

Collective proceedings were introduced to allow large numbers of people affected by breaches of competition law – who, individually, might not have the resources to pursue litigation – to combine their claims under the leadership of a class representative. There are two kinds of collective proceedings: "opt-in", where the representative claims on behalf of all those who have expressly chosen to participate; and "opt-out", where the claim is made on behalf of all persons domiciled in the UK who match a particular description, except for those who have expressly chosen not to participate.

An action by a proposed class representative (a **PCR**) can only proceed if the Competition Appeal Tribunal certifies a collective proceedings order (a **CPO**). A CPO will only be granted if the CAT: (i) authorises the PCR on the basis that it is "just and reasonable" for them to act as a representative in the proceedings (the "authorisation condition"); and (ii) certifies that the claims are eligible for inclusion in collective proceedings (the "eligibility condition").

The Supreme Court's decision in Merricks significantly lowered the bar for CPO certification and incentivised claimant law firms and funders. This has resulted in a huge increase in the number of CPO applications (with more than 30 currently pending in the CAT). While the CAT has generally adopted a claimant-friendly approach at the certification stage, recent developments may suggest a slight shift of approach.

AUTHORISATION CONDITION

In order to be authorised, a PCR must (among other things) persuade the CAT that it has adequate funding arrangements in place. Collective proceedings are invariably financed by professional litigation funders; they have typically done so in return for a percentage of the damages recovered in the event the claim succeeds. In July 2023, the Supreme Court took the market by surprise by **holding** that litigation funding agreements of this kind are caught by the definition of damages-based agreements (DBAs). DBAs are prohibited in opt-out collective proceedings and will only be enforceable in opt-in proceedings if they comply with certain conditions.

In a recent decision, the CAT held that a funding agreement revised in the light of the Supreme Court's decision – so that the funder would be paid a multiple of its investment, rather than a percentage of damages – was not a DBA and was, accordingly, valid. It remains to be seen whether that decision will be appealed. Meanwhile, the Government has proposed a change to the law which would remove the prohibition on DBAs in opt-out proceedings, but not address the underlying question of whether the definition of DBAs should be amended to take litigation funding agreements outside their scope more generally.

ELIGIBILITY CONDITION

In considering whether claims are eligible for inclusion in collective proceedings, the CAT will consider a number of factors including whether they: (i) raise common issues of fact or law; and (ii) are suitable to be brought as collective proceedings. The CAT and Court of Appeal have confirmed the low threshold (including by reiterating that suitability is a relative concept requiring the CAT to consider whether a claim is more suitable to be brought in collective proceedings rather than individual proceedings).

In **Trains**, the Court of Appeal explained that to enable the CAT to form a judgment on commonality and suitability, the PCR must put forward a methodology setting out how the relevant issues will be determined at trial. In **McLaren**, the Court of Appeal emphasised the CAT's gatekeeper function in ensuring that the PCR puts forward a clear "blueprint to trial" at the certification stage. Multiple respondents have therefore sought (mostly unsuccessfully) to persuade the CAT that the relevant PCR's expert methodology has fallen short of the required standard. However, in **Meta** and **CICC**, the CAT did take what appears to be a more stringent approach: it refused to certify the claims, although gave the respective PCRs time to improve them. It remains to be seen whether the concept of "blueprint to trial" will allow respondents to challenge certification.

OPT-IN VS OPT-OUT

The choice between opt-in and opt-out proceedings has been a key battleground in a number of CPO applications. In two recent decisions, the Court of Appeal noted that:

A. the CAT should exercise its discretion based on all circumstances of the case and that there is no legislative presumption either way;
B. it should not be that a weaker case necessarily becomes opt-in and a stronger case opt-out; and
C. where no proceedings will continue save on an opt-out basis, that is a powerful factor in favour of opt-out.

2024 TRENDS

There has been a significant increase in standalone abuse of dominance claims against tech companies, with CPO applications filed against Google, Meta, Qualcomm, Apple and Amazon.

A separate emerging trend is claimants seeking novel ways to use the collective proceedings regime by framing claims for alleged non-compliance with environmental law or regulation in other areas as competition law breaches. We are currently representing defendant companies in collective proceedings in multiple different sectors.

We expect that it will be difficult to persuade the CAT that opt-out proceedings are unsuitable (particularly for consumer claims) but, given the high stakes, we may see creative arguments on the issue of opt-in vs opt-out.

Given the developing state of the law around collective proceedings, we expect to see both PCRs and respondents continue to test the limits of certification arguments.

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WORKPLACE MISCONDUCT: IDENTIFYING AND HANDLING RISK

The character and conduct of business leaders has become an increasingly topical issue – a trend compounded by a string of high-profile resignations triggered by the personal conduct of senior figures. It is not only the individuals', conduct that makes headlines; organisations and how they respond to and investigate this conduct are also in the spotlight. In a landscape of increasing scrutiny and changing attitudes on what conduct is acceptable, organisations need to understand the various factors in play and adopt effective measures to address them at an early stage.

Philip Linnard
Partner

Philippa O'Malley
Partner

OVERVIEW OF REGULATORY REGIME

The conduct of directors and other senior figures is governed by an expansive regime which stems from a range of different sources, including:

- directors' duties, contained in the Companies Act 2006 and accompanying case law;
- contractual provisions in, for example, the employee's employment contract;
- company policies, which often cover topics including equity and inclusion, workplace behaviour, discipline and reporting;
- the Senior Managers and Certification Regime (SM&CR), which requires relevant firms to assess the fitness and propriety of certain employees and corresponding conduct rules; and
- the Equality Act 2010, which seeks to protect people from discrimination and harassment.

This regulatory regime continues to adapt and grow. For example, the Worker Protection (Amendment of Equality Act 2010) Act 2023 imposes a new duty on employers to take reasonable steps to prevent sexual harassment.

EXPOSURE FOR COMPANIES AND BOARDS

The need for companies and boards to effectively address inappropriate personal conduct is heightened by their exposure to significant risks.

- Legal: misconduct within organisations can lead to legal claims brought by colleagues, and to difficult legal situations when deciding how to deal with the individual in question. The range of legal issues that can arise from instances of misconduct includes whistleblowing and related claims, victimisation and harassment claims, discrimination claims, constructive and/or unfair dismissal claims and in companies subject to FCA and/or PRA regulation, difficult questions relating to how and when to report misconduct to the regulators, and the attendant risk of challenge from the person who is the subject of the report.

- Regulatory or criminal investigation: poor conduct could trigger one or more regulatory regimes, such as those set out above, and serious misconduct such as sexual assault, theft, or financial impropriety, may lead to criminal investigation.
- Reputational: irresponsible actions, unethical business cultures and an ineffective response by the organisation, can seriously damage the trust and confidence of a business' stakeholders, including staff, investors and customers.
- Financial: workplace misconduct can damage a company's share price and create significant financial costs, for example those resulting from disruption and turbulence amongst management and possible follow-on litigation. Claims for discrimination and harassment also attract unlimited compensation.

REDUCED TOLERANCE

The likelihood of exposure is much higher now than in the past. Staff and investors feel more empowered to raise issues, and there is greater connectivity and media interest. Plus, stakeholders have less tolerance for poor behaviour, including behaviour that doesn't have a criminal element or otherwise falls below the level of producing a legal claim.

There is also evidence of regulators taking workplace misconduct more seriously. The FCA and PRA, for example, have recently published consultation papers that target improving diversity and inclusion. They are also proposing more comprehensive guidance on non-financial misconduct and to expressly include it within their conduct rules and fitness and proprietary assessments. Similarly, the Equality and Human Rights Commission has been active, recently undertaking investigations of, and reaching agreements with, McDonald's Restaurants Limited, Jaguar Land Rover Ltd and Sainsbury's.

WORKPLACE RELATIONSHIPS

The increased level of exposure has also been felt by a number of companies as a result various failures by senior figures to disclose past relationships with employees.

The effects of such departures demonstrate how important it is for businesses to manage and be seen to be managing the risks – both present and future – associated with workplace relationships or other conduct of this kind. A company might, for example, require any workplace relationships to be disclosed, or it might impose a ban on such relationships.

BEST PRACTICE

Given the increased focus on improper management and conduct, companies ought to be thinking about best practice. There is a general trend towards greater transparency, but companies could also consider:

- recruitment processes, and what qualities to look for when hiring new employees;
- creating codes of conduct, and reviewing these at regular intervals;
- developing effective whistleblowing mechanisms;
- putting in place a dedicated investigations team and processes - which can be relied on if an investigation is needed; and
- if the alleged conduct involves a criminal or regulatory element, what that means for the investigation and whether any reporting obligations have been triggered.

Please speak to your Slaughter and May contact for further advice about how to adopt better practice, prevent workplace misconduct and how to deal with it if it arises.

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CYBERSECURITY IN 2024

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The global cyber threat landscape will continue to evolve in 2024 alongside rapid technological and geopolitical developments. Potential risks from AI, a renewed focus from ransomware gangs and the difficulties in mitigating supply chain risk are issues that organisations need to manage. We've also seen the emergence of state-aligned actors as a new threat to critical infrastructure. As the risks continue to evolve, so too does the legal and regulatory landscape, with new rules expected to take effect in 2024.

Cyber risk can be mitigated with a well-considered preparedness strategy. While this may not prevent all attacks, it will flag issues to fix and provides a clear guide on how to manage an attack effectively. It is vital that organisations regularly update, and practice, their cyber incident response plans, stress-testing them in simulations, ensuring key stakeholders understand their roles and responsibilities and evolving plans to take into account current risks.

RANSOMWARE

In its latest annual review, the UK's National Cyber Security Centre warns that "Ransomware remains one of the most acute cyber threats facing the UK, and all domestic organisations should take action to protect themselves from this pervasive threat." It is important that your organisation understands how it would respond to a ransomware attack. While governments and regulators warn against payment, there are a range of issues an organisation will need to weigh up before making that decision. The first is, whether it is lawful to pay (and there are circumstances where it is not).

The key to a successful ransom response is therefore having the ability to assess, in real time, the threat facing your organisation. For example, who are the threat actors? Can you do reasonable diligence on their track record, behaviours and the seriousness of their threats? Are they inside your systems and have they copied your data? Are your backups sufficient? How long would it take to recover (whether or not you pay the ransom)? Will they release confidential/sensitive information? And are you covered by insurance?

In the coming year, it will be important for organisation to monitor the changing ransomware landscape as new threat actors, tactics and regulatory requirements emerge.

SUPPLY CHAIN

The recent Capita, MOVEit and Zellis cyber attacks are a reminder of the importance of considering supply chain risk. As companies increase their cyber security, threat actors are increasingly targeting their suppliers, who may be less secure and therefore offer a "weak link" into that organisation's systems. Alternatively, ransomware gangs may target high value (e.g. outsourcing or IT) suppliers who offer access to multiple organisations once breached.

Traditionally supply chain risk has been a blind spot for many organisations. However, recent government research suggests this is starting to change – at least in larger organisations where over half are now reviewing supply chain risk.

That said, effective supply chain management, particularly beyond first tier suppliers, is difficult. It must include new suppliers acquired into your supply chain through M&A, and legacy suppliers who still hold your data, as well as current service providers (and their suppliers).

Legislators and regulators are alive to supply chain risk, and there are plans to bring material IT service providers under both the critical infrastructure (NIS), and financial regulatory, regimes.

FINES

Fines are a reality for cyber breaches and draft guidance from the UK's data regulator suggests high penalties could be more common in future. Duplicate fines are also a risk for cross-border breaches or where different laws apply to the same incident. For example, Equifax was recently fined by the UK financial regulator despite previously receiving a fine for the same incident from the data regulator (the ICO). ICO fines will also be calculated without prejudice to any compensation claims, which again could lead to a double payout.

We are, however, increasingly seeing that proactive remediation and investigation can help reduce the size of fines.

CONCLUSION

Cyber continues to be a board level risk. Throughout 2024, organisations should regularly update and rehearse their cyber incident response plans, and keep pace with the evolving threat, and legal, landscape.

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