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CROSS-BORDER M&A: A CHECKLIST OF U.S. ISSUES FOR NON-U.S. ACQUIRERS

– THOUGHT LEADERSHIP

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Cross-border M&A transactions can be far more complex than purely domestic transactions. With advanced planning and careful consideration of relevant issues, however, it is almost always possible to navigate this complexity successfully and achieve the parties' commercial objectives. Here is an overview of some of the key issues that should be considered by non-U.S. acquirers contemplating acquisitions or other strategic investments in the United States.

While global M&A activity stagnated during the first half of 2020 after remaining relatively steady throughout 2019, due in no small part to the pandemic, global M&A deal value began to rebound during the second half of 2020, with the total value of deals in Q4 2020 up by 24.5% compared with Q1 and Q2 combined, and up 49% compared with Q4 of 2019.[1] This paints a relatively optimistic picture for global dealmakers, especially those considering cross-border transactions.

Deal Structure: Tax and other considerations

Acquisition Structures. The choice of acquisition structure in M&A is typically driven by the characteristics of entities involved in the transaction, including their respective entity type (under local law), entity classification (for U.S. tax purposes), jurisdictions of organization and the nature of their capital structures and related shareholder base, together with the unique tax considerations of the deal and the parties' commercial objectives.

Acquisitions of U.S. public companies are usually structured as either a statutory merger or a tender offer (which is followed by a second-step statutory merger to squeeze out any remaining stockholders of the target company who do not participate in the first-step tender offer) that is subject to various regulatory requirements and review by the U.S. Securities and Exchange Commission (SEC). Acquisitions of U.S. private companies, by contrast, provide far greater structuring flexibility because they generally are not subject to the same regulatory requirements or SEC review that apply to takeovers of public companies. Accordingly, while acquisitions of private companies can (and often do) take the form of a merger, direct acquisitions of stock and assets are also common though tender offers are rare.

Subject to certain exceptions, parties to a transaction that is structured as an acquisition of assets have the ability to select the assets and liabilities to be transferred to the acquirer and to be retained by the seller. An acquirer of assets generally does not inherit the U.S. tax basis of the seller in the assets being sold. Accordingly, asset acquisitions are often thought to facilitate tax-efficiencies for the acquirer because if the acquirer is able obtain a "step-up" in the tax basis of the acquired assets, then the acquirer should be able to further depreciate those assets over time as well as reduce the acquirer's tax liability related to a future sale of those assets.

By contrast, parties to a transaction that is structured as a merger or an acquisition of stock do not have this ability because the target company in

1. Source: Mergermarket, Global & Regional M&A Report 2020

those cases (which is the seller in an asset deal) continues to own the same assets. Accordingly, in deals structured as a merger or an acquisition of stock, the target company's historic liabilities, including liabilities for unpaid U.S. taxes as well as its U.S. federal income tax attributes (such as net operating losses), generally remain with the target company (although subject to certain requirements, certain tax elections can be made to treat the purchase of stock as a purchase of assets). If an acquisition is structured as a share-for-share merger, then the target company's historic tax liabilities as well as its U.S. federal income tax attributes generally shift to the acquirer.

Acquisition Vehicles. Non-U.S. acquirers should also consider the choice of acquisition vehicle based on potential tax treatment (of both the transaction and the business post-closing) and the nature of the target company's business and assets. Non-U.S. acquirers typically use a U.S. corporation as the acquisition vehicle for asset acquisitions of a U.S. business because a U.S. corporation benefits from the low U.S. federal corporate income tax rate and because non-U.S. acquirers can avoid being treated as being directly engaged in a U.S. trade or business (which can introduce significant tax complexities). Alternatively, non-U.S. acquirers can also use non-U.S. corporations (or non-corporate entities) as the acquisition vehicle for acquisitions of stock of a U.S. target company. If a non-U.S. acquirer acquires the stock of a U.S. target company, and the non-U.S. acquirer is eligible for the benefits of an applicable tax treaty with the United States, then dividends, interest or royalties that the non-U.S. acquirer receives from the U.S. target corporation may be subject to reduced rates of U.S. withholding taxes (or such taxes might be eliminated entirely).

Accordingly, tax planning in the context of determining a transaction structure should take into account not only the tax consequences of the transaction itself (e.g., whether the transaction is intended to be taxable or tax-deferred), but also the implications of operating the newly acquired U.S. business after the closing (e.g., cross-border flows of goods and services, the repatriation of cash and other distributions, the availability of U.S. tax treaties, etc.). Careful tax structuring is important because the applicable taxing authority (e.g., the U.S. Internal Revenue Service) can challenge the tax characterization of a transaction if it does not agree that the characterization reflects the substance of that transaction.

Continued Effects of Tax Reform. Tax reform in the United States in 2017 has had, and will continue to have, a profound impact on cross-border M&A activity, as well as the strategies used to execute, and the negotiation dynamics in, cross-border deals. The centerpiece of the reforms was the federal reduction in the corporate tax rate from 35% to 21%. Even if U.S. tax legislation is enacted under a new Biden administration, it seems unlikely that the federal corporate tax rate will return to its previous heights. Instead, it is likely that this and many other key features from the 2017 tax reforms that may be relevant to non-U.S. acquirers will remain in place. Among other things, these key features include a limitation on the ability to deduct net interest expense in excess of a percentage of EBITDA (or EBIT, for 2022 and beyond), provisions temporarily permitting immediate or greatly accelerated write-offs for certain tangible property expenditures, rules concerning the taxation of foreign earnings of U.S.-based multinationals (taxing those earnings on a current basis), rules targeting deductions on hybrid instruments (e.g., instruments held by a related party that are treated as debt by the payor and as equity by the payee), changes to the ability to utilize net operating losses, and a minimum tax imposed on large U.S. companies that effectively limits the benefit of deductible payments such companies make to non-U.S. affiliates. Because U.S. taxes can have a significant impact on the global effective tax rate of non-U.S. acquirers with significant U.S. operations, it is essential to model the impact of these and other key features of the U.S. tax law regime using company-specific facts prior to committing to any acquisition structure.

Acquisition Funding. Tax considerations can also affect the method of acquisition funding used by a non-U.S. acquirer. If debt funding is used, then debt placement and collateral security should be carefully planned, and limits on the deductibility of interest should be carefully considered, to fit the overall structure and related tax modelling. If intercompany debt is used or debt is "pushed down" from a non-U.S. parent to a U.S. subsidiary, then complex conduit financing rules, tax treaty considerations, and rules on recharacterization of debt will need to be taken into account. If the acquisition is funded by issuing common or preferred equity, then dividend withholding rates and tax treaties applicable to the non-U.S. acquirer will need to be taken into account.

Other Considerations. If the contemplated transaction is potentially politically sensitive or likely to face regulatory resistance, alternative structural considerations may include one or more of the following:

- minority or other non-controlling investments;
- joint ventures;
- contractual partnerships with a U.S. company or management team or partnering with a U.S. source of financing or co-investor (such as a private equity firm);
- utilizing a controlled or partly controlled U.S. acquisition vehicle, possibly with a board of directors comprised of U.S. citizens; or
- implementing bespoke governance structures (such as a U.S. proxy board) with respect to specific sensitive subsidiaries or businesses of the target company.

There are pros and cons associated with each of these structures, but depending on the commercial objectives of the parties each one of these structures could potentially help to facilitate a deal.

Foreign investment review (CFIUS)

The Committee on Foreign Investment in the United States (CFIUS) is an inter-agency committee authorized to review transactions involving the acquisition of control of, and certain non-controlling investments in, a U.S. business by a non-U.S. person to determine the effect of a transaction on the national security interests of the United States. Industries that have historically drawn the greatest scrutiny from CFIUS include defense, aerospace, computers and electronics, heavy machinery, software publishing, utilities and mining. More recently, however, transactions involving critical technology, critical infrastructure and the personal data of U.S. nationals (referred to as "TID U.S. businesses")[2] are of heightened interest to CFIUS, with semiconductors and 5G technology being leading examples.

If the parties make a CFIUS filing regarding their transaction and CFIUS notifies the parties that it is satisfied that the filing contains all required information, an initial review period of up to 45 days is commenced. After the initial review period, CFIUS will either clear the transaction based on its initial review if it concludes that the transaction does not present any national security risks or, if it cannot do so, initiate a subsequent investigation that may last up to an additional 45 days. If after further review CFIUS concludes that the transaction presents national security risks, then CFIUS may request the parties to agree to mitigation measures prior to closing, impose conditions on the acquirer's post-closing operation of the acquired business or, in the worst case, refuse to clear the transaction. The range of mitigation measures that CFIUS can impose is intentionally broad and the actual measures sought to be imposed by CFIUS depend on the risk profile of the deal. Ultimately, at the conclusion of the subsequent investigation and any related negotiations with the parties with respect to potential mitigation measures,

2. Technology, infrastructure and data.

CFIUS will submit a recommendation to the President of the United States, and the President will have 15 days to clear, prohibit or suspend the transaction. Careful advanced planning, which often includes designing both a legal and a political strategy (including by "pre-conditioning" CFIUS), greatly enhances the likelihood of a successful outcome.

The CFIUS landscape has changed rapidly in recent years, including with respect to new regulations implementing the U.S. Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) that took effect on February 13, 2020. Under the new regulations, non-controlling investments (in addition to controlling investments) by non-U.S. investors are subject to CFIUS review if certain criteria are met, such as an investment in a TID U.S. business. But such non-controlling investments may also qualify for an exemption if they involve an "excepted foreign state" (which currently includes Australia, Canada and the United Kingdom) or an "excepted foreign investor" (which generally include non-U.S. investors that (a) are organized under the laws of an excepted foreign state, (b) have their principal place of business in an excepted foreign state or in the United States and (c) have a board of directors (or equivalent), at least 75% of which is comprised of nationals from excepted foreign states or the United States). Further, in contrast to the previously voluntary nature of CFIUS filings, the CFIUS filing regime now includes mandatory filing requirements for certain transactions, namely those involving a substantial non-U.S. investment in a TID business and those involving a U.S. business that produces, designs, tests, manufactures, fabricates or develops one or more critical technologies for which a "U.S. regulatory authorization" (such as licenses under the International Traffic in Arms Regulations (ITAR) and the Export Administration Regulations (EAR)) would be required for the export, re-export, transfer (in-country) or retransfer of such critical technologies to certain non-U.S. entities involved in the transaction or in the non-U.S. acquirer's ownership chain.

Even in situations where a transaction falls outside the scope of the mandatory filing regime, there may still be a powerful incentive for parties to seek clearance in order to preclude CFIUS from seeking to require the non-U.S. acquirer to divest the U.S. business after the acquisition has closed.[3] While CFIUS officially states that specific countries are not singled out for enhanced review, CFIUS's most recent divestiture orders suggest that there will likely continue to be heightened scrutiny when Chinese investors are involved. In many situations, including those involving Chinese investors, it has become increasingly popular to try to address the risk of failing to obtain CFIUS clearance through the use of termination fees payable by the non-U.S. acquirer if clearance is not obtained. In addition, non-U.S. acquirers based in countries that restrict or otherwise regulate the flow of capital in connection with outbound investments may be subject to requests from U.S. sellers to secure the payment of these types of reverse termination fees through the use of U.S. collateral structures, including U.S. dollar denominated escrow accounts held in the United States by U.S. banks.

Merger control

The Antitrust Division of the U.S. Department of Justice (DOJ) and the U.S. Federal Trade Commission (FTC) have the power to review the competitive aspects of proposed transactions – even transactions that do not result in changes of control or involve U.S. companies.

Transactions that exceed certain reporting thresholds are subject to mandatory premerger notification requirements under the U.S. Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the HSR Act). A notification filing must be submitted to both the DOJ and the FTC, and the transaction cannot be completed until the applicable waiting period has expired.

3. While historically unusual, this has occurred with greater frequency in recent years, for example in connection with (1) the 2019 acquisition by Beijing Kunlun Tech of an interest in Grindr, (2) the 2019 acquisition by iCarbonX of an interest in PatientsLikeMe, (3) the 2012 acquisition by Ralls Corporation of four wind-farm projects in Oregon and (4) the 2011 acquisition by Huawei of operating assets from 3Leaf computing. Note that the non-U.S. acquirer in each of these cases was Chinese.

If a notification filing is required, the parties must wait 30 calendar days (15 calendar days in the case of cash tender offers and certain bankruptcy situations) after the filing to complete the transaction, unless early termination of the waiting period is requested and granted. Either the FTC or the DOJ may request additional information (a so-called "second request") from the parties and extend the waiting period an additional 30 calendar days (10 calendar days in the case of cash tender offers and certain bankruptcy situations). Requests for early termination of the waiting period are granted in a substantial majority of transactions – typically two or three weeks after the initial waiting period begins. If the request for early termination is granted, it becomes a matter of public record; accordingly, parties that wish to keep the clearance confidential for strategic reasons will typically elect not to request early termination.

Coordinating antitrust/merger control filings and substantive strategies across multiple jurisdictions can be a substantial undertaking and the commercial and timing implications for the deal can be significant. In some cases, for example, the DOJ/FTC might challenge a transaction as anti-competitive and sue to block the deal, which is what occurred recently in 2018-19 with AT&T's $85 billion acquisition of Time Warner[4] as well as in November 2020 with Visa's proposed $5.3 billion acquisition of Plaid. More typically, however, transactions that raise substantive antitrust concerns may become subject to DOJ/FTC-mandated divestiture orders or other similar remedies that are negotiated by the parties and the agencies and are intended to resolve the agencies' concerns, such as in the case of the UTC-Raytheon merger (where UTC and Raytheon agreed to divest a GPS systems business and a military radio business) and the CVS-Aetna merger (where Aetna agreed to divest its stand-alone Medicare prescription drug business). Because of these implications, non-U.S. investors will want to have a good understanding of the substantive risk profile of the proposed transaction, and the remedies most likely to be sought by the DOJ/FTC, when negotiating so-called "hell or high water,"[5] reverse termination fee and other risk-shifting provisions.

Regulated industries

In addition to CFIUS and merger control requirements, various U.S. federal and state regulatory requirements (including regulatory filing and consent requirements) may apply to acquisitions of companies operating in particular sectors, including, for example, registered investment funds/advisers, banking/financial institutions, energy, power and natural resources, maritime, utilities, communications, aviation, transportation, gaming, defense and insurance. In such cases, complying with such requirements, including seeking and obtaining any related approvals can sometimes be cumbersome and time-consuming.

Securities laws and mandatory offer requirements

General. Non-U.S. acquirers that intend to offer and sell securities in the United States in connection with a U.S. investment may become subject to the SEC's registration requirements, which is an expensive and time-consuming process, and consequently the SEC's ongoing periodic reporting requirements. Under the U.S. Securities Act of 1933 (the Securities Act), the offer and sale of securities must be registered with the SEC unless the securities being offered and sold, or the related transaction pursuant to which they are offered and sold, is specifically exempted. The most commonly used exemptions for acquisitions of privately held target

4. Unlike horizontal mergers, vertical mergers (such as the AT&T-Time Warner merger) are challenged much less commonly and any such challenges prior to AT&T-Time Warner have always been resolved in the form of settlements and concessions negotiated outside the courtroom. While the DOJ ultimately lost the suit against AT&T and Time Warner, both the DOJ and the FTC have since announced plans to issue new vertical merger guidelines. Accordingly, it is not prudent for parties to assume that vertical mergers are subject to less scrutiny than horizontal mergers.

5. A "hell or high water" provision shifts the risk related to obtaining antitrust clearance to the acquirer by obligating the acquirer to do whatever is required to obtain clearance, including by agreeing to any divestment or other remedy proposed by the FTC/DOJ.

companies are so-called "private placement" exemptions for transactions that do not involve a public offering of securities.[6] Non-U.S. acquirers seeking to use their stock as consideration in an acquisition of a private company may be able to qualify for such private placement exemptions, which eliminates the time and expense associated with a registered transaction. Non-U.S. acquirers seeking to use their stock as consideration in an acquisition of a U.S. public company, however, will not be able to take advantage of the private placement exemptions and therefore will be required to register with the SEC the offer and sale of their stock in the acquisition. Additionally, registration requirements under the securities laws of each state (known as "blue sky" laws) involved in the particular transaction apply to the offer and sale of securities unless an exemption is available. Notably, securities offered and sold through certain private placements and securities listed on a U.S. stock exchange (e.g., NASDAQ or NYSE) are exempt from state blue sky laws, though certain notice filings, consent to service of process and payment of filing fees may apply.

Education/Transparency. Non-U.S. acquirers seeking to offer and sell securities in the United States as deal consideration should also keep in mind that for some shareholders of U.S. target companies, particularly shareholders of U.S. public companies that are accustomed to U.S. securities laws and stock exchange listing rules that are designed to promote transparency and disclosure, additional coordination and planning may be needed to help educate those shareholders in respect of the disclosure regime of the non-U.S. acquirer that would apply if the target company's shareholders were to accept the shares of such non-U.S. acquirer. Even in the case of a non-U.S. acquirer that is or becomes a so-called "foreign private issuer" for U.S. securities law purposes, it is not required to comply with the U.S. proxy rules, to file the same periodic reports with the SEC or to have a majority of its directors be independent, all of which are required of U.S.-domiciled, SEC-registered reporting companies.

Insider Trading; Stakebuilding; Disclosure Requirements. Non-U.S. acquirers seeking to purchase stakes in U.S. public companies must, among other things, take into account the restrictions on insider trading imposed pursuant to Rule 10b-5 under the U.S. Securities Exchange Act of 1934 (the Exchange Act), the potential requirement to publicly report beneficial ownership of shares (and other information about the acquirer and its intentions with respect to the target company) in excess of 5% pursuant to Section 13(d) of the Exchange Act and the "short-swing profits" rules imposed by Section 16(b) of the Exchange Act (which potentially can require disgorgement of profits from trading after the acquirer's position in the target company's shares exceeds 10%). Moreover, U.S. federal laws (such as the HSR Act), the laws of the state of the target company's domicile (such as "anti-takeover" laws) and the target company's governance documents may contain provisions that limit the number of shares that can be acquired, or require certain approvals to be obtained, in connection with such acquisitions.

Mandatory Offer Requirements. There are no mandatory offer requirements in the United States, but non-U.S. acquirers should take care to ensure that any share purchases do not constitute a *de facto* or “creeping” tender offer that would be subject to U.S. tender offer rules.

Corrupt business practices and economic sanctions

Corrupt Business Practices. Regulators around the world continue to focus on corrupt business practices. First-time investors in the United States should appreciate that their exposure to risk under the U.S. Foreign Corrupt Practices Act (the FCPA) could increase significantly if they acquire a U.S. business. If a non-U.S. acquirer is

6. Section 4(a)(2) of the Securities Act exempts from registration transactions by an issuer that do not involve a public offering of securities. Most private placement offerings today are conducted under Rule 506 of Regulation D of the Securities Act, which is considered a "safe harbor" under Section 4(a)(2) because it sets out certain standards that, if met, allow an issuer to satisfy the requirements of a Section 4(a)(2) exemption.

required to register its shares with the SEC in the United States, including in connection with any listing on a U.S. stock exchange in connection with an acquisition of a U.S. target company, it will invariably become subject to the FCPA and potentially U.S. sanctions regimes (depending on the levels of entanglement between the U.S. target company and its affiliates and the nature of the group's business and geographic exposure).

Among other things, the FCPA makes it unlawful for subject persons and entities (including non-U.S. issuers of securities who have a class of securities registered pursuant to Section 12 of the Exchange Act or that are required to file reports with the SEC pursuant to Section 15(d) of the Exchange Act) to make a payment or provide anything else of value to a non-U.S. government official for the purpose of obtaining or retaining business for or with, or directing business to, any other person. These provisions also apply to non-U.S. companies and their representatives who take any action in furtherance of a corrupt payment while in the United States or while making use of interstate commerce in the United States. Importantly, government officials can include officials of state-owned enterprises (SOEs).

Economic Sanctions. U.S. businesses also must comply with U.S. economic sanctions, which can extend to non-U.S. acquirers if their activities involve U.S. businesses or they otherwise have certain requisite touchpoints with the United States. U.S. economic sanctions are primarily administered by the Office of Foreign Assets Control (OFAC) of the U.S. Department of the Treasury, and are designed to further U.S. foreign policy and its national security interests and objectives. Accordingly, economic sanctions are generally targeted at non-U.S. countries and regimes, terrorists, narcotics traffickers, those engaged in activities related to the proliferation of weapons of mass destruction and similar perceived threats to the national security, foreign policy, or economic interests of the United States.

Director fiduciary duties

Although M&A deals are typically proposed by the senior executive team, the board of directors (or equivalent) of the U.S. target company/seller often must determine whether a potential transaction can proceed beyond an initial exploratory phase. In making their determination, directors of Delaware corporations[7] are subject to and guided by two primary fiduciary duties: the duty of care and the duty of loyalty. The duty of care requires directors to engage in an informed and deliberate decision-making process based on all material information reasonably available to them. The duty of loyalty requires directors to act on a disinterested and independent basis, in good faith and with an honest belief that the action proposed to be taken is in the best interest of the corporation and its stockholders. In general, under a standard of judicial review referred to as the "business judgment rule," directors are entitled to a rebuttable presumption that in making decisions they acted in accordance with their fiduciary duties. If the business judgment rule is not rebutted by plaintiffs, it prevents a court from second-guessing board decisions on business matters, including M&A transactions, as long as those decisions are attributed to any rational business purpose. In M&A transactions, however, courts may more carefully scrutinize the decisions of the board and examine the overall decision-making process, including the quality of information consulted, the procedures followed and the reasonableness of a board's actions.[8]

While fiduciary duties apply to directors of both private and public corporations, if the target company is a public company, there are many formalities and procedural

7. While not always the case, it is common for U.S. target companies/sellers to be corporations organized under the laws of the State of Delaware. Directors of U.S. corporations that are organized under the laws of U.S. states other than the State of Delaware will be subject to similar fiduciary duties if the state in which they are organized follows Delaware law in this area. If they do not, or if the applicable target company/seller is a non-corporate legal entity, then different considerations may apply.

8. In certain circumstances that are beyond the scope of this article, directors may be subject to more demanding standards of judicial review when determining whether they discharged their fiduciary duties in the context of an M&A transaction.

protections that guide a board of directors' participation in an M&A process, including for example with respect to the use of outside legal counsel, one or more outside financial advisors and independent committees or obtaining an informed vote of minority shareholders. These formalities and procedures are designed to help directors satisfy their fiduciary duties as well as protect the transaction against heightened judicial scrutiny if the deal is ever challenged in court, but it can sometimes be difficult for non-U.S. acquirers to understand all of the nuanced requirements. As a result, non-U.S. acquirers need to be well-advised as to the role of U.S. public company boards and the legal, regulatory and litigation framework and risks that drive a target company board's actions.

Litigation

The United States is known to be one of the most litigious countries in the world. As a result, companies that are investing or otherwise conducting business in the United States must be prepared to defend themselves within that system against a wide range of potential complaints relating to their business operations. This can also sometimes be the case with respect to M&A activity.

While litigation related to takeovers of U.S. private companies is rare, litigation related to takeovers of U.S. public companies is common, though generally not a cause for concern. Excluding situations involving competing bids, where litigation may play a direct role in the contest, and going-private or other "conflict" transactions initiated by controlling shareholders or management of the target company, there are very few examples of major acquisitions of U.S. public companies failing due to litigation, or of materially increased costs arising out of litigation being imposed on arm's-length acquirers. Nevertheless, most acquisitions of U.S. public companies involve state law claims by shareholders of the public company related to alleged breaches of fiduciary duties by the public company's board of directors. These claims typically assert that the sales process undertaken by the board of directors and its advisers was insufficient or otherwise flawed, that the price is too low and that deal protection measures to which the company agreed either discourage or prevent third parties from making superior competing bids. These claims, together with claims under U.S. federal securities laws, also typically assert that the disclosure made by the company regarding the transaction in documents used to solicit shareholder approvals was inaccurate or otherwise misleading. While certainly a nuisance, these types of claims, in which shareholders generally seek to delay or prevent the deal and related damages, are usually easily resolved for enhanced disclosure and modest sums relative to the overall value of a transaction.

HR considerations

Navigating U.S. labor and employment-related considerations can sometimes be a challenge for non-U.S. acquirers, particularly in cases where human capital represents a large percentage of the deal value. In addition to legal and regulatory compliance (such as benefit plan operational concerns and deferred compensation issues), and integration of employees following the transaction, one of the most significant employment considerations is how to compensate and retain key employees of the target company. This issue is often particularly acute when ultimate ownership changes from a U.S. to a non-U.S. jurisdiction. Developing solid people-management plans that are put into effect at the outset of the transaction and carried out through closing and into the post-closing integration phase can be critically important. Consider the following key points:

- Acquirers commonly enter into new employment arrangements with key members of the target company's management team in connection with an acquisition to help ensure a smooth transition and stable post-closing leadership.
- Most U.S. sellers insist that acquirers maintain a level of employee compensation and benefits (often including performance incentives and severance) – that is similar to the target company's existing compensation and

benefits structure – for a transitional period after the closing (typically 12-24 months).

- U.S. employers often use non-compete agreements as a method of preserving critical human capital. The enforceability of these non-compete agreements is, and historically has been, a facts and circumstances analysis that varies from state to state. In general, states typically provide that a non-compete agreement is enforceable if it is reasonable in scope and duration, and is bargained for in exchange for consideration. The most notable exception to this general rule of enforceability is in the State of California, where non-compete provisions in the employment arena are generally not enforceable by law (however, in certain circumstances, non-compete agreements bargained for in connection with the sale of a business may be enforceable against a key employee who is also a seller of that business). The law in this area continues to evolve, however, and some state legislatures, including in the State of Massachusetts, have passed laws that are designed to promote competition and therefore tend to be more favorable to employees. Needless to say, companies with a multi-state workforce cannot take a one-size-fits-all approach to non-compete agreements and well-advised non-U.S. acquirers carefully tailor non-compete agreements and other restrictive covenant agreements based on the nuanced rules in each jurisdiction.
- Cash and equity incentive plans, including transaction-related bonuses, are often implemented by non-U.S. acquirers and U.S. target companies to stabilize the workforce in connection with a transaction. Establishing these types of programs on a tax-efficient basis is critical. Many U.S. target companies will have existing arrangements for management that will need to be terminated or (in certain transaction structures) assumed upon closing. Costs associated with the termination, cash settlement or other treatment of a target company's equity or other incentive awards should be considered when a non-U.S. acquirer is negotiating its own incentive compensation arrangements for retained executives, and also should be taken into account when determining the purchase price.
- If a non-U.S. acquirer is seeking to carry out headcount reductions, it may be relatively easier to do so in the United States than in many non-U.S. countries. In contrast to many non-U.S. countries in which employers may only terminate employees for cause, employment in the United States is predominantly "at-will," which means, as a general matter, that an employer can terminate an employee or otherwise change the terms of the employee's employment relationship at any time in its sole and absolute discretion. Although both common law and statutory exceptions to the at-will rule exist, at-will employment is a bedrock principle in the United States. If headcount reductions will be large scale in nature or result in the closing of a particular worksite, non-U.S. acquirers must be aware of notification requirements that might be triggered under U.S. federal state employment laws.
- Trade unions, works councils and other employee representative bodies are far more common outside the United States than in the United States. Where trade unions are involved, however, there can be significant additional obligations and requirements under the law and any collective agreements between the employer and the unions. A non-U.S. acquirer will also want to understand the potential costs around any promised increases in benefits or compensation under the terms of a collective bargaining agreement or any such increases that might result from negotiations around the renewal of an expiring collective bargaining agreement.

Intellectual property and data protection

Intellectual Property. Intellectual property (IP) is protected in the United States by a well-developed body of statutory and common law that is designed to protect the owner's right to use IP as well as to prevent the unauthorized exploitation of IP by others. The scope and strength of the protection, however, differ depending on the nature of the IP right (e.g., unregistered trade secrets versus statutory copyrights or patents for software products), and the industry in which the owner of the IP operates, so the extent and depth of legal due diligence need to be calibrated accordingly. For example, IP due diligence for a biotechnology company is likely to focus on a small handful of patents, whereas IP due diligence for a software company is likely to focus on the processes for ensuring that ownership of IP created by employees and consulting developers vests in the target company. Because the default laws designed to allocate ownership of IP rights are not harmonized across jurisdictions or across the different types of IP, the processes for conferring valid ownership of IP in the United States do not necessarily ensure that the target company will enjoy valid ownership of the IP outside of the United States. Consequently, if an acquirer's business plan depends on certain IP rights conferring protection over a particular technology, the acquirer should carefully consider how that technology is, or can be, protected both in and outside of the United States.

Data protection. In contrast to some non-U.S. jurisdictions, the United States does not have a single comprehensive federal data privacy and data security law. Instead, there is a fragmented and dynamic patchwork of federal laws and regulations (largely promulgated by the FTC), state laws and industry standards or "best practices" that apply differently across jurisdictions, industries and data subjects.

Since the European Union's General Data Protection Regulation (GDPR) took effect in 2018, however, the data regulatory landscape in the United States has begun to shift significantly towards a more comprehensive regulatory regime. Starting with the California Consumer Privacy Act, which took effect on January 1, 2020, other U.S. states and local municipalities, including the State of New York and the City of San Francisco in the State of California, have adopted their own data protection regulations.

In light of the increased regulatory push and several large-scale data breaches that have occurred in recent years, and given that the non-U.S. acquirer will often assume the liabilities of the U.S. target company for past non-compliance with privacy laws, potential acquirers must tailor their due diligence exercise to the risk profile of the target company. Often, an acquirer's due diligence should focus not only on the jurisdiction in which the target company is domiciled, but also and often more importantly on the jurisdictions and industries in which the target company operates, collects personal data, processes such data, offers products or services and monitors individuals. For instance, given the GDPR's extraterritorial scope and increased fines for noncompliance, it is important to assess the potential applicability of the GDPR even for U.S. target companies that do not have a strong nexus to the European Union. The $123 million fine on Marriott under the GDPR regime for the Starwood data breach, which was already ongoing prior to Marriott's purchase of Starwood in 2016, serves as a reminder to potential non-U.S. acquirers of U.S. businesses to fully investigate the data privacy and data security risks of their targets inside and outside of the United States.

Politics and local market practice

Politics. The role of politics in cross-border M&A varies greatly. Especially in the current pandemic climate, it is likely that we will continue to see increasing political intervention in cross-border transactions and heightened levels of regulatory scrutiny and nationalism. This means that non-U.S. investors may need to rethink their approach to and timeline for a transaction, as well as prepare a narrative that is convincing to applicable regulators and other political stakeholders. It is critical to remember for this purpose that "politics" extends beyond federal and state regulators, and includes other constituencies such as key customers, suppliers and employees, and any such narratives should be tailored accordingly. The importance of identifying in advance the key constituencies that could influence the success of the transaction and figuring out how best to address their potential concerns should not be underestimated. In some cases, particularly in the case of a high-profile transaction in a sensitive sector, or in a situation involving an SOE, politics (separate and apart from CFIUS) need to be carefully and thoroughly considered before any public announcements concerning the deal.

Local Market Practice. In the same vein, understanding and accepting local market M&A practice can help to ensure a smooth process and, particularly in a competitive auction setting, help to put a non-U.S. acquirer on equal footing with its U.S. competition. While there may be situations in which it is appropriate to depart from market custom and practice, non-U.S. acquirers who blindly insist on doing it "the way we do it at home" often find it difficult to succeed.

Patient and experienced advisers can be useful in this regard, and conforming to local market custom and practice rarely results in unacceptable levels of risk and may even result in better outcomes than can be expected in the home market. And while it is natural for non-U.S. acquirers to want to engage legal, financial, accounting and other advisers with whom they have worked in the past in their home markets, it is almost always advisable to also engage local U.S. advisers (even if only the U.S. colleagues of trusted non-U.S. advisers) who are familiar with U.S. concepts. These include, for example, U.S. generally accepted accounting principles and common approaches to purchase price adjustments, as well as U.S. market practice more generally, including as it relates to auction practice, disclosure practice and various other aspects of M&A practice that is detailed elsewhere in this article.

Representations and warranty insurance

In recent years, representation and warranty insurance (RWI) has become increasingly popular in the United States, particularly in the private M&A space, and is now standard market practice for transactions in which financial sponsors are acting as sellers. With increased competition among underwriters, RWI policies are more affordable and prevalent than ever, and can be implemented on an expedited basis in parallel with the primary deal negotiations.

The key benefit of RWI to the seller is obvious – the limitation or elimination (so-called "no survival deals," which have become increasingly common) of the seller's liability for losses incurred by the acquirer that result from breaches of representations and warranties by sellers or target companies. But using RWI can also benefit non-U.S. acquirers:

- RWI can help make the acquirer's bid in an auction process more attractive.[9]
- RWI can meaningfully reduce time and effort spent on negotiating the acquisition agreement, which can be a critical factor in a competitive process.
- RWI can be helpful in cases where the acquirer would like to preserve important post-closing relationships with the seller by allowing the acquirer to seek to recover its losses from a creditworthy insurer under its RWI policy instead of directly from the seller.
- The seller may be more willing to expand the substantive coverage of its representations and warranties and reduce the use of qualifiers, thereby expanding the acquirer's basis for recovery under the RWI policy.

RWI, however, has its limits. As the name suggests, RWI only covers the acquirer's losses that result from breaches of the seller's/target company's representations and warranties and not losses that result from breaches of the seller's/target

9. Some practitioners would assert that this argument is no longer persuasive, at least in situations where financial sponsors are selling and RWI is now customary and therefore expected, if not required. In situations where corporate or other non-financial sponsor entities are selling, however, the proposed use of RWI by potential acquirers may in fact make their bid more attractive.

company's covenants, including any failure by the seller/target company to operate its business in the ordinary course prior to closing and any post-closing payment obligations that might arise under a purchase agreement. Coverage for a target company's pre-closing taxes is another area that may pose a trap for the unwary. While a seller's stand-alone tax indemnity in favor of the acquirer for pre-closing taxes of the target company can provide fulsome coverage for breaches of relevant tax representations and warranties, the RWI policy would typically not cover taxes that are accrued but not yet payable for pre-closing periods. And not surprisingly, RWI also typically does not cover other types of known risks, contingent or otherwise.[10]

10. There are certain exceptions to this general rule of thumb, but they are beyond the scope of this article.

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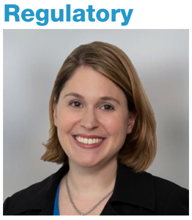

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