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Cross-Border M&A –
Checklist for Successful Acquisitions in the U.S.

Cross-border M&A and strategic investment continues to increase, injecting much-needed liquidity into the U.S. and other constrained economies and spreading the benefits of a fluid transnational deal market. So far in 2008, about $246 billion of announced deals in the U.S. (representing 36% of the year-to-date total) have involved non-U.S. acquirors or investors, as compared to $370 billion (25%) in 2007, $185 billion (12%) in 2006, and $132 billion (11%) in 2005. Outbound acquisitions and strategic investments by U.S. companies have also been growing in volume, from $146 billion in 2005 to $334 billion in 2007.

Notably, acquisitions and strategic investments in the U.S. emanating from China, India and countries with natural resource wealth or currencies that have gained sharply against the dollar have been increasing particularly rapidly, driven by the extraordinary economic growth and capital accumulation in those regions, opportunities in the U.S. created by the weak dollar and the credit crisis, and the strategic benefits of acquiring American brands, resources, distribution systems and technology. The growth in Chinese outbound activity has been especially noteworthy, with more than $40 billion of foreign acquisitions announced so far this year, already representing double last year's full-year volume. Indian outbound activity has also been on the upswing over the past several years, with $10 billion of foreign acquisitions announced so far this year, and acquisitions and investments from resource-rich economies have similarly been increasing. Buoyed by the strong Euro, European companies have also continued to move aggressively in the cross-border arena, with InBev/Anheuser-Busch and Roche/Genentech being just the latest examples.

Despite the impression by some that the current environment in the U.S. is not particularly welcoming, the U.S. is the largest recipient of Chinese, Indian and Middle Eastern outbound acquisitions and strategic investments by value (generally with over 20% market share in 2007 and 2008 year-to-date) and remains one of the top, if not the top, targets for most European companies for deals outside of Europe. A small number of failed deals (especially CNOOC/Unocal and Dubai Ports World) have clearly raised concerns about excessive protectionism in the U.S., but deal practitioners have absorbed the lessons from those failures and gained in sophistication, as evidenced by Chinalco and Alcoa's joint acquisition of a stake in Rio Tinto, Sinosteel's successful hostile acquisition of Midwest Corp, CNOOC's success with its bid for Awilco Offshore ASA, and the pending takeover battle between India's Sterlite Industries and Grupo Mexico for the assets of U.S.-based Asarco.

Sophisticated players have come to understand that other than in the defense sector and a small list of other highly sensitive areas, most transactions in the U.S. can be implemented through careful advance preparation, strategic implementation, and deal structures that anticipate likely concerns. It is important to recognize that despite occasional outbreaks of protectionist rhetoric (particularly during election years), the U.S. is fundamentally committed to open markets and welcomes foreign acquisitions and investment.

Following is our checklist of important issues that should be considered in advance of any acquisition or strategic investment in the U.S. Of course, each cross-border deal is different, and implementation of the checklist will depend on the facts, circumstances and dynamics of the particular situation:

- *Political Considerations*. A comprehensive analysis of political implications should be undertaken well in advance of any acquisition proposal, particularly if the target company is in a sensitive industry or if the acquiror is sponsored or financed by a foreign government. It is imperative that the likely concerns of federal, state and local government agencies, employees, customers, suppliers, communities and other interested parties be thoroughly considered and, if possible, addressed strategically prior to any acquisition or investment proposal becoming public. Acquirors should not make the mistake of assuming that it is sufficient to deal solely with the executive branch of the federal government – many other parties have potential leverage (economic, political, regulatory, public relations, etc.) and those that do will need to be approached with sensitivity and forethought. Rules of common sense apply: for example, when dealing with a local politician, determine the local benefits of the deal (whether they be good jobs, strengthening the local tax base, or revitalizing an area) and then draw a clear roadmap of how the deal will deliver them.

- *Transaction Structures*. Acquirors should be willing to consider a variety of potential transaction structures, especially in sensitive deals. Structures that may be helpful in particular circumstances include no-governance and low-governance investments, minority positions or joint ventures, possibly with the right to increase to greater ownership or governance over time; making the acquisition in partnership with a U.S. firm or management, or in collaboration with a U.S. source of financing or co-investor; or utilizing a controlled or partly-controlled U.S. acquisition vehicle, possibly with a board of directors having a substantial number of U.S. citizens and a prominent American as a non-executive chairman. Use of preferred securities (rather than plain common) or structured debt securities should also be considered.

- *Collaboration*. Most obstacles to a deal are best addressed in partnership with local players whose interests are aligned with those of the acquiror. If possible, relationships with the target company's management and other local forces should be established well in advance so that political and other concerns can be addressed together, and so that all politicians, regulators and other stakeholders can be approached by the whole group marching in tandem. Local support will go a long way towards reducing the appearance of a foreign threat.

- *Regulatory Obstacles*. Any weaknesses in the ability to clear regulatory obstacles could be used by reluctant targets, competing bidders or competitors of the target to frustrate the acquisition. In addition to securities and antitrust regulations, acquirors should plan for a review by the Committee on Foreign Investment in the United States (CFIUS) under the Exon-Florio Act, discussed below; and, in transactions involving regulated industries (*e.g.*, energy, public utilities, gaming, insurance, telecommunications and media, financial institutions, and defense contracting), an additional layer of approvals is often required and needs to be taken into account as part of advance planning and timing.

- *CFIUS*. The U.S. Congress' passage of the Foreign Investment and National Security Act of 2007, which amends the Exon-Florio Act, highlights the continuing scrutiny of cross-border transactions and the critical importance of advance planning by acquirors. Transactions most likely to attract the greatest scrutiny by CFIUS, the multi-agency governmental body that reviews transactions in which foreign acquirors could obtain "control" of a U.S. business or assets or involve investments by foreign governments or investments in U.S. infrastructure, technology or energy assets. Three useful rules of thumb in dealing with CFIUS are, first, that in general it is prudent to make a voluntary filing with CFIUS if the likelihood of an investigation is reasonably high or if competing bidders are likely to take advantage of the uncertainty of a potential investigation; second, that it is often best to take the initiative and suggest methods of mitigation early in the review process in order to help shape any remedial measures and avoid delay or potential disapproval; and, third, that it is often a mistake to make a CFIUS filing naked, without advance discussions with U.S. Treasury officials and other relevant parties. (Our July 13, 2007 and April 24, 2008 memos on CFIUS provide further information in this regard.) CFIUS is not as mysterious or unpredictable as some fear – consultation with U.S. Treasury and other officials (who want to be supportive) and CFIUS experts will generally provide a good sense of what it will take to clear the process.

- *Sound, Sophisticated M&A Practice*. It is essential to understand the custom and practice in U.S. M&A transactions. Successful execution is more art than science, and early involvement by experienced U.S. advisors will be important. Understanding when to respect – and when to challenge – a target's sale "process" is critical. Knowing how and at what price level to enter the discussions may make or break a proposal – in some situations it is prudent to start with an offer on the low side, while in others offering a full price at the outset may be essential to achieving a negotiated deal and discouraging competitors, including those who might raise political or regulatory issues. In sensitive transactions, hostile maneuvers may be imprudent; in other cases, unsolicited pressure might be the only way to make something happen.

- *Litigation*. Shareholder litigation is fairly routine in transactions in the U.S. and is generally not a cause for concern. In most cases, such litigation is settled for relatively small amounts or other concessions, with the positive effect of foreclosing future claims and insulating the company from future liability, much like buying an insurance policy. Sophisticated counsel can usually predict the likely range of settlement costs, which should simply be viewed as a cost of the deal. In all cases, the acquirors' shareholders and domestic reporters and watchdogs should be conditioned in advance to expect litigation and not to view it as a sign of trouble.

- *Tax Considerations*. Tax issues may be critical to structuring the transaction. Non-U.S. acquirors contemplating a dividend stream flowing from the U.S. target should structure with a view toward withholding tax requirements and should consider the possibility of utilizing a subsidiary located in a country that has a favorable tax treaty network or other tax attributes that will minimize the taxes imposed on the dividends as they cross borders. The proportion of debt and equity will be important from a tax perspective, as will obtaining U.S. interest deductions on acquisition indebtedness. In tax-free (stock-for-stock) acquisitions, special rules applicable to foreign acquisitions may be relevant.

- *Disclosure Obligations*. How and when an acquiror's interest in the target is publicly disclosed should be carefully controlled and considered, keeping in mind the various ownership thresholds that trigger mandatory disclosure on a Schedule 13D under the securities laws and under regulatory agency rules such as those of the Federal Reserve Board, the Federal Energy Regulatory Commission, and the Federal Communications Commission. While the Hart-Scott-Rodino Antitrust Improvements Act does not require disclosure to the general public, the Hart-Scott rules do require disclosure to the target's management before relatively low ownership thresholds can be crossed.

- *Understanding the Market*. Understanding in advance the roles of arbitrageurs, hedge funds, institutional investors, private equity funds, proxy voting advisors and other important market players – and their likely views of the anticipated acquisition attempt – can be pivotal to the success or failure of the contemplated transaction.

- *Financing*. The recent credit market upheaval has put even more scrutiny on the financing aspects of transactions. Critical questions to consider include where financing with the most favorable terms and conditions is available; how committed the financing is; which lenders have the best understanding of the target's business; whether to reach out to alternative, non-traditional financing sources; and how comfortable the target will feel with the terms and conditions of the financing.

- *Integration Planning*. One of the reasons deals sometimes fail is poor post-acquisition integration, particularly in cross-border deals where multiple cultures, languages and historic business methods may create friction. If possible, the executives and consultants that will be responsible for integration should be involved in the early stages of the deal so that they can help formulate and "own" the plans that they will be expected to execute. Too often, a separation between the deal team and the integration/execution teams invites slippage in execution of a plan that in hindsight is labeled by the new team as unrealistic or overly ambitious. However, integration planning needs to be carefully phased in as implementation cannot occur prior to the time most regulatory approvals are obtained.

- *Corporate Governance and Securities Law*. U.S. securities and corporate governance rules can be troublesome for non-U.S. acquirors who will be issuing securities that will become publicly traded in the U.S. as a result of an acquisition. SEC rules, the Sarbanes-Oxley Act and stock exchange requirements should be evaluated to ensure compatibility with home country rules and to be certain that the non-U.S. acquiror will be able to comply. Rules relating to director independence, internal control reports and loans to officers and directors, among others, can frequently raise issues for non-U.S. companies listing in the U.S.

- *Antitrust Issues*. To the extent that a non-U.S. acquiror directly or indirectly competes or holds an interest in a company that competes in the same industry as the target company, antitrust concerns may arise either at the federal agency or state attorneys general level. Although less typical, concerns can also occur if the foreign acquiror competes either in an upstream or downstream market of the target. Pre-closing integration efforts should also be sensitive to antitrust considerations.

- *Due Diligence*. Wholesale application of the acquiror's domestic due diligence standards to the target's jurisdiction can cause delay, waste time and resources, or result in missing a problem. Due diligence methods must take account of the target jurisdiction's legal regime and, particularly important in a competitive auction situation, take account of local norms. Making due diligence requests that appear to the target as particularly unusual or unreasonable (not uncommon in cross-border deals) can easily cause a bidder to lose credibility. Similarly, missing a significant local issue for lack of local knowledge can be highly problematic.

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Global capital flows, multinational enterprises and cross-border M&A activity have never been as common or as sensitive as they are today. With advance planning and careful attention to the greater complexity and spectrum of issues that characterize cross-border M&A, such transactions can be accomplished in most circumstances without falling into the pitfalls and misunderstandings that have sometimes characterized cross-cultural business dealings.

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