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U.S. UPDATE – Checklist for Successful Acquisitions in the U.S.

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Editors' Note: This submission updates a checklist co-authored by Messrs. Emmerich and Panovka, members of XBMA's Legal Roundtable, with their partners at Wachtell Lipton, Scott K. Charles, David A. Katz, Ilene Knable Gotts, Andrew J. Nussbaum, Joshua R. Cammaker, Mark Gordon and Joshua M. Holmes.

Executive Summary/Highlights:

- U.S. M&A volume over the last 12 months was just shy of US$1 trillion, including almost $200 billion of cross-border acquisitions in the U.S.by non-U.S. investors or acquirors.
- Despite some well-publicized examples of thwarted deals and fears of growing protectionism, the U.S. deal markets remain open to non-U.S. acquirors and investors. The Obama Administration's nascent plan to attract US$1 trillion of foreign investment into the U.S. over the next five years, as a way to boost jobs, may signal increased openness.
- Except in the defense sector and other strategically sensitive areas, most acquisitions in the U.S. can be effected through careful advance preparation, strategic implementation, and deal structures that anticipate likely concerns.
- Critical in planning any cross-border deal in the U.S. is an early evaluation of political and regulatory constraints and a thoughtful strategy for addressing them; determination of the optimal structure for the transaction; thinking through how best to clear CFIUS; determining the appropriate acquisition currency and financing strategy; understanding U.S. disclosure and securities law obligations; evaluating litigation risk; and the other topics covered below.

MAIN ARTICLE Despite some recent concern over sluggishness, the U.S. M&A market remains active, with just under US$1 trillion of announced deals over the last 12 months, representing 37% of global M&A volume during that period. Perhaps more interesting to non-U.S. market participants, almost 20% of the announced U.S. deals over the last 12 months involved non-U.S. investors or acquirors. The numbers clearly show that, despite some well-publicized examples of thwarted deals and fears of growing protectionism, the U.S. deal markets remain highly liquid and accessible to non-U.S. acquirors and investors. Sophisticated market participants have come to understand that, except in the defense sector and other strategically sensitive areas, most acquisitions in the U.S. can be effected through careful advance preparation, strategic implementation, and deal structures that anticipate likely concerns. Cross-border deals involving investment into the U.S. are more likely to fail because of poor planning and execution than due to fundamental legal restrictions.

Following is our updated checklist of 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 and Regulatory Considerations*. Even though foreign investment in the U.S. remains generally well received and rarely becomes a political issue in the context of specific transactions, prospective non-U.S. acquirors of U.S. businesses should undertake a comprehensive analysis of the U.S. political and regulatory implications well in advance of any acquisition proposal or program, 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. Similarly, the potential regulatory hurdles require sophisticated advance planning. In addition to securities and antitrust regulations, acquisitions may be subject to CFIUS review (discussed below), and acquisitions in regulated industries (*e.g.*, energy, public utilities, gaming, insurance, telecommunications and media, financial institutions, transportation, and defense contracting) may be subject to an additional layer of approvals. Regulation in these areas is complex, and political opponents, reluctant targets and competitors may seize on any perceived weaknesses in an acquiror's ability to clear regulatory obstacles.
- *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. company or management, or in collaboration with a U.S. source of financing or co-investor, such as a private equity firm; 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 ordinary common stock) or structured debt securities should also be considered. Even more modest social issues, such as the name of the continuing enterprise and its corporate seat, or the choice of the nominal acquiror in a merger, can affect the perspective of government and labor officials.
- *CFIUS*. Under U.S. federal law, the Committee on Foreign Investment in the United States (CFIUS) – a multi-agency governmental body – has discretion to review transactions in which foreign acquirors could obtain "control" of a U.S. business or in which a foreign acquiror invests 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 and other officials and relevant parties. CFIUS is not as mysterious or unpredictable as some fear – consultation with U.S. Treasury and other officials (who generally want to be supportive and promote investment in the U.S. economy) and CFIUS experts will generally provide a good sense of what it will take to clear the process.

- *Acquisition Currency*. While cash remains the predominant (although not exclusive) form of consideration in cross-border deals, non-U.S. acquirors should think creatively about potential avenues for offering U.S. target shareholders a security that allows them to participate in the resulting global enterprise. For example, publicly listed acquirors may consider offering existing common stock or depositary receipts (*e.g.*, ADRs) or entering into dual-listing arrangements. When target shareholders will obtain a continuing interest in a surviving corporation that had not already been publicly listed in the United States, expect heightened focus on the corporate governance and other ownership and structural arrangements of the non-U.S. acquiror, including as to the presence of any controlling or large shareholders, and heightened scrutiny placed on any *de facto* controllers or promoters.
- *M&A Practice*. It is essential to understand the custom and practice in U.S. M&A transactions. For instance, understanding when to respect – and when to challenge – a target's sale "process" may be 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. U.S. takeover regulations differ in many respects from those in non-U.S. jurisdictions; for example, the mandatory bid concept common in Europe, India and other countries is not present in U.S. practice. Permissible deal protection structures, pricing requirements and defensive measures available to U.S. targets also may differ from what the non-U.S. acquirer is accustomed to in deals in their home countries. Sensitivity must also be given to the distinct contours of the target board's fiduciary duties and decision-making obligations under U.S. law.
- *Distressed Acquisitions*. Distressed M&A is a well developed specialty in the U.S., with its own sub-culture of sophisticated investors, lawyers and financial advisors. When evaluating a distressed target, acquirors should consider the full toolbox that may be available, including acquisition of the target's

fulcrum debt securities that are expected to become the equity through an out-of-court restructuring or plan of reorganization, acting as a plan investor or sponsor in connection with a plan, backstopping a plan-related rights offering, or participating as a bidder in a court-supervised "Section 363" auction process, among others. Acquirers also need to consider the differing interests and sometimes-conflicting agendas of the various constituencies, including bank lenders, bondholders, distressed-focused hedge funds and holders of structured debt securities and credit default protection.

- *Financing.* Ongoing volatility in the credit markets has increased scrutiny on the financing aspects of transactions. Important 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 explore alternative, non-traditional financing sources and structures, including seller paper; and how comfortable the target will feel with the terms and conditions of the financing. Note that under U.S. law, unlike the laws of some other countries, foreign acquirors are not prohibited from borrowing from U.S. lenders, and they generally may use the assets of U.S. targets as collateral. Likewise, the relative ease of highly-structured financing in the U.S. market should be a benefit to the incoming acquiror, with both asset-based and other sophisticated securitized lending strategies relatively easy to implement and available in the market.
- *Litigation.* Shareholder litigation is routine in transactions in the U.S. and is generally not a cause for concern. In most cases, where a transaction has been properly planned and implemented with the benefit of appropriate legal and investment banking advice on both sides, 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. Sophisticated counsel can usually predict the likely range of settlement costs, which should be viewed as a cost of the deal. In all cases, the acquiror, its directors, 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 relative proportions 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 HSR rules do require disclosure to the target's management before relatively low ownership thresholds can be crossed. Non-U.S. acquirors have to be mindful of disclosure norms and timing requirements relating to home country requirements with respect to cross-border investment and acquisition activity. In many cases, the U.S. disclosure regime is subject to greater judgment and analysis than the strict requirements of other jurisdictions. Treatment of derivative securities and other pecuniary interests in a target other than straight common stock holdings also vary by jurisdiction and have received heightened focus in recent periods.

- *Shareholder Approval*. Few U.S. public companies have one or more controlling shareholders, a circumstance which renders shareholder approval, where required, a key variable. 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 as well as when they appear and disappear from the scene – can be pivotal to the success or failure of the contemplated transaction.
- *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 and Dodd-Frank Acts 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. Non-U.S. acquirers should also be mindful that U.S. securities regulations may apply to acquisitions and other business combination activities involving non-U.S. companies with U.S. security holders.
- *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 conducted with sensitivity to antitrust considerations. Home jurisdiction competition laws may raise their own sets of issues that should be carefully analyzed with counsel.

- *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.
- *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.

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