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CROSS-BORDER MERGERS

International Business: Mergers and Acquisitions in a Cross-Border Context

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Savvy technology firms employ a range of methods for expanding into foreign markets. Tech companies venturing abroad should carefully evaluate the most promising foreign market entry strategy in each particular country of interest.

The different foreign market entry strategies are best viewed along a spectrum progressing from lower to higher degrees of commitment, investment, integration and control. At the lower end one finds contractual arrangements ranging from direct export to more involved scenarios of commercial agency, distributorship, licensing, franchising and various collaboration and resource sharing arrangements. In the middle are situated more sustained collaborative investment strategies, including acquisitions of minority stakes in existing foreign enterprises and the establishment of ventures jointly owned with a local partner. At the upper end of the spectrum are the most challenging yet potentially rewarding foreign direct investment (''FDI'') scenarios, which include traditional cross-border mergers and acquisitions and greenfield ventures.

Determining the mode of foreign market entry that presents the right fit for a technology business is a complex endeavor that warrants careful, and often significant, planning and analysis. This is not the time for a ''quick-and-dirty'' decision-making process, as there is no ''one size fits all'' solution available. Chief among the factors influencing the decisions are the company's long-term strategic goals, its degree of international experience and familiarity with the new market(s), the extent of resources that it can commit, the degree of risk it is willing to incur, its network of existing relationships, the general industry environment in which it operates, and the particular characteristics of its products and services.

This article and webinar will present a high-level overview of traditional M&A in the cross-border context – i.e., transactions in which a 100% or nearly 100% interest in a foreign enterprise is acquired.

M&A Versus Greenfield Investment. It is worthwhile to make a few preliminary observations concerning greenfield investment (i.e., the creation of overseas ventures from the ground up, typically using a wholly-owned local subsidiary established by the parent), as tech companies adopting FDI strategies frequently find themselves deliberating between M&A and greenfield (i.e., the ''buy'' vs. ''build'' decision). Not surprisingly, of the numerous factors that influence these choices, many are fundamental business issues concerning commercial and long-term strategic goals; different companies will thus weigh them differently. Ultimately, the particular capabilities (and the mobility of such capabilities) that the investing company aims to bring to bear in, or conversely to derive from, the new market(s) tend to drive the decision-making process.

A technology business that pursues an M&A strategy is purchasing access not just to the tangible and IP assets of the target, but also to a valuable trove of country-specific information, experience and capabilities (including the collective skill-set of the target's work-

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force). A technology business that possesses relatively little familiarity with a host country and its economy may shy away from a greenfield investment in favor of M&A options. Similarly, a business whose strategic priority is to take advantage of perceived synergies between its own capabilities and those of a foreign enterprise will ordinarily look to traditional M&A as the preferred local market entry option.

Conversely, the greenfield investor is essentially bringing its own capabilities to bear in the local market(s), and the extent to which those capabilities are easily portable across borders will influence the success of the investment. For many tech companies, the prospect offered by greenfield investments of avoiding the challenge of integrating an acquired business into the larger parent organization is appealing. Moreover, the extent of potential liabilities of the acquired business (as is often the case, for example, where a high level of corruption exists in the host country) may drive the expanding technology enterprise to a more rigorous analysis of a greenfield FDI approach.

Bridging the Cultural Divide

The oft-noted ''culture gap'' that complicates cross-border M&A transactions goes beyond legal and regulatory variations to encompass all manner of linguistic, relational, values-based and other differences arising from the distinct social and business traditions that participants bring to the table. Divergent language requirements, negotiating styles, nonverbal communication modes, and even attitudes toward the legal profession all carry the potential to impede the negotiation, execution and implementation of deals if not proactively anticipated and addressed.

While the myriad cultural frictions in global M&A practice are beyond the scope of this article, it should be noted that cultural obstacles are most often effectively addressed through early recognition, communication and planning; close cooperation with local counterparties, partners and advisors; and a pragmatic readiness to ''do as the Romans do.'' Successful cross-border investors pay close attention to relevant areas of cultural difference at every stage of deal planning, execution and implementation—including post-acquisition—and are prepared to meet the challenges in a spirit of collaboration, flexibility, accommodation and respect.

The Cross-Border Due Diligence Investigation

Due diligence is the process of obtaining and validating material information about a target's business and identifying potential liabilities, risks and other significant issues affecting the business and the proposed M&A transaction. Diligence is necessary to determine the exact nature and characteristics of what is purchased, verify the valuation and other key commercial assumptions, identify and allocate risks, and determine optimal transaction structure and process. It is also a key aid in preparing a post-acquisition integration strategy. In addition, for U.S. buyers engaging in outbound M&A, thorough pre-acquisition review is increasingly important to limit potentially significant successor liability under the federal Foreign Corrupt Practices Act (''FCPA'').

Buy-side due diligence review, a key part of even purely domestic M&A deals, assumes a heightened importance in the cross-border acquisition context, as the risks posed to foreign investors of an inadequately conducted diligence exercise are magnified. Many challenges are interposed – language and cultural barriers, different systems of law and conventions of legal practice, unfamiliar accounting standards and documentation practices, constraints of local data privacy laws, unfamiliar corporate and management structures – which can impede due diligence investigations. Physical distance and time zone differences can complicate the basic logistics of conducting cross-border diligence and the timely aggregation, analysis and reporting of findings.

A crucial ingredient for a successful and effective cross-border due diligence exercise is a thorough comprehension of the scope and objectives at the outset. All participants across the various diligence workstreams must have a good understanding of the strategic rationale for the acquisition; the deal's jurisdictional reach; the contemplated structure (assets or shares); the nature of the target's business, including in relation to the buyer's business (competing or complementary); the negotiating framework (auction or negotiated); and the desired timeframe. Absent such an understanding, even an otherwise well-organized diligence effort may fail to unearth key legal and commercial risks, reduce the likelihood that suitably protective deal terms will be negotiated, and hamper successful post-acquisition integration.

A deficient due diligence process is thus one of the greatest deal risk factors from a buyer's perspective. Prudent precautions to mitigate this risk include the following:

-Prioritize the Commercially Pragmatic Diligence Exercise and Define Scope of Work With Precision. Due diligence priorities should be driven, first and foremost, by the strategic rationale for the transaction – for example, acquisition of intellectual property assets or product lines, new key business relationships or market penetration – but with an eye on commercial pragmatism. The buyer should agree with its outside legal advisors what key legal diligence needs to be carried out in order to support that strategic rationale, and which non-material risks can be ignored. Appropriate monetary and other quantitative materiality thresholds should be established for such items as contracts, litigation and

Note to Readers

In cooperation with Baker & McKenzie LLP, BBNA will host a webinar Oct. 23, 1:00 p.m.-2:00 p.m. ET, ''International Business: Mergers and Acquisitions in a Cross-Border Context.'' The authors of this article—Matthew Gemello, Christian O'Connell and Marc Paul—will present a high-level overview of traditional M&A in the cross-border context, including transactions in which a 100- or nearly 100-percent interest in a foreign enterprise is acquired.

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other liabilities. Key contracts or those that raise significant legal issues should be priorities. Note here, however, that even small contracts can give rise to significant exposure under FCPA or local anti-corruption statutes and may need to be carved out of monetary materiality thresholds. The same can be true with respect to contracts that trigger the application of trade sanctions or export controls.

– Practice Good Project Management and Organization. Even a modest-sized international acquisition review may involve a large and diverse cast of participants that includes the buyer's internal teams, outside legal advisors (including both global lead counsel and local counsel), financial and accounting advisors, and consultants with topical expertise in various areas (e.g., environmental, insurance or human resources). Care must be taken to eliminate the risks of duplication of effort or, conversely, inadequate coverage. Well-defined areas of responsibility and clear channels of communication should be established.

– Ensure Clear, Timely and Useful Reporting. Ensuring prompt sharing of material information with other interested reviewers is key. Diligence reviewers should be mindful of potential ''deal stoppers'' and report these to the teams responsible for negotiation and documentation as soon as such issues are uncovered, rather than waiting until interim or final diligence reports are delivered. To avoid the common problem of ''information overload'' for the buyer's decision-makers, the appropriate level of detail and style of presentation of the diligence report to be prepared should also be agreed in advance (the current practice trend increasingly favors streamlined ''red flag'' or ''exceptions only'' reports). Where potential problems are identified, the legal team should take a proactive approach and propose possible solutions, rather than passively reporting material findings. Such solutions may include recommended avenues of additional or confirmatory investigation, contractual mitigation strategies through representations, warranties and indemnities for identified risks, or even changes to the proposed transaction structure to exclude certain assets or liabilities (and in some cases, entire problematic business units) from the deal.

Special Reporting for Compliance Issues. As M&A due diligence investigations have expanded in recent years to include efforts aimed at unearthing possible corrupt practices, it has become increasingly common for a buyer to commission a separate FCPA compliance investigation of the target business in parallel with the main due diligence review. FCPA issues, when they are relevant to a particular deal, are increasingly likely to attract attention from the buyer's board of directors, and in such cases the board will appreciate delivery of a stand-alone FCPA due diligence report. Maintaining a separate FCPA diligence workstream also helps avoid unnecessary distributions of sensitive FCPA-related information to the wider acquisition review team. Moreover, the buyer's FCPA counsel will often engage and direct the work of forensic accountants and other specialized nonlawyer advisors, which – at least in the United States – offers the advantage of extending the attorney-client privilege to communications with such advisors.

Privilege and Privacy Concerns. Both in-house and outside counsel should be aware during pre-acquisition review (and indeed throughout the lifecycle of a cross-border M&A transaction) that the rules protecting attorney-client communications against disclosure to third parties can vary significantly from jurisdiction to jurisdiction and do not universally resemble the robust evidentiary privilege familiar to U.S. lawyers. Care should be taken, in consultation with qualified local counsel, to adopt communication protocols that mitigate the risks of unprotected communications or the inadvertent waiver of confidentiality protections. In addition, counsel and businesspersons alike need to be aware that many jurisdictions severely restrict the cross-border transfer of protected personal information, including that of employees and customers. Accordingly, the diligence exercise needs to be undertaken with those restrictions firmly in mind.

Documenting the Transaction

Choice of Governing Law. A fundamental decision for cross-border M&A deals involves what jurisdiction's law will govern the transaction documents and related disputes between the buyer and the seller. The choice of governing law will have wide-ranging repercussions on deal planning and implementation. The content of the main purchase agreement and ancillary documentation may vary significantly depending on which body of law is selected by the parties (for example, whether the agreement relies on extensively drafted representations and warranties, as tends to be customary in countries with the common law tradition, or relies on statutory law to supply certain substantive terms, as is the case in many civil law countries). Ideally the parties should broach this subject and reach agreement on governing law at the outset of the transaction process, but in practice this rarely is a topic that the lead business negotiators wish to prioritize.

The natural reflex of a buyer, particularly one in a superior bargaining position, is to seek to impose its home country's law and its standard domestic transaction form documents on the seller. Depending on the particular deal in question, however, following this instinct is not always in the buyer's interest, and the suitability of other bodies of law – with an eye toward the buyer's ability to realize fully its desired remedies – should be the subject of expert evaluation. In this regard, note that court judgments based on U.S. law can be very difficult to enforce in many foreign countries. Nonetheless, as a general rule, situating the parties' contractual relationship within a stable, predictable and well-developed legal environment is an important part of a foreign investor's overall risk mitigation strategy. In all events, care should be taken in the governing law clause to exclude conflicts of laws principles that could result in the unintended application of a body of law different from that selected by the parties, particularly if a neutral jurisdiction's law is expressly selected (a relatively common compromise between buyers and sellers). The parties and their counsel should also bear in mind that mandatory provisions of local law may supersede the parties' choice of law as to specific substantive areas; and indeed more general restrictions on the choice of foreign law (as with certain kinds of FDI transactions in China, for example) may apply as well.

An invalid choice of law, or the unexpected application of a different body of law, can introduce significant uncertainty over the respective rights and obligations of the parties in the event of a dispute. Both internationally and locally experienced counsel should review the transaction documents to ensure that they adequately factor in differences between the applicable law and the system of contract law with which the buyer may be most familiar.

Finally, the selection of a forum for disputes (including the choice between court jurisdiction and arbitration) should be considered in parallel with choice of law negotiations as part of an overall M&A dispute resolution strategy.

International Acquisition Agreements. As with domestic M&A transactions, international M&A deals ordinarily involve a principal transaction agreement governing the acquisition of assets or equity interests. The cross-border context, however, presents an added degree of complexity for the transaction documentation.

Similar to its domestic analogue, the purchase agreement for a cross-border M&A transaction will typically include a number of structural elements: definitions intended to prevent interpretive problems and elaborate complex deal-specific concepts; mechanical provisions to establish what is changing hands on each side and how the transaction will be consummated; provisions that describe purchase price adjustments, where applicable; various conditions that must be satisfied or waived in order to achieve closing; representations and warranties offering a baseline picture of the target business and its assets and liabilities at the time of signing (tied to a set of disclosure schedules providing either exceptions to the statements made or a list of information required by such statements); pre-closing affirmative and negative covenants governing the conduct of the target's business and the relations between the parties prior to closing; termination provisions; remedies and indemnification provisions whereby the seller will indemnify the buyer against certain losses; provisions selecting a body of governing law and a forum for the resolution of disputes; and miscellaneous other clauses. The chief aim of the main acquisition agreement is, naturally, to give binding legal effect to the transfer of ownership of the acquired property (generally shares or business assets) and to the other negotiated terms and conditions of the parties' business deal.

The principal acquisition agreement will typically be accompanied by other ancillary agreements and instruments, which may include parent guarantees, releases, employment and consulting agreements, non-competition agreements, transitional services agreements (generally where the target business is being divested from a larger integrated business), and various specialized instruments of conveyance. While these are generally negotiated in parallel with the main agreement, such ancillary agreements will frequently present similar international complexities to those encountered in the main agreement. Such subordinate documents should be reviewed to ensure compliance with local legal requirements and consistency with the terms of the principal acquisition agreement.

Note that local law will often prescribe documentary requirements and other formalities for the legal conveyance of share or asset ownership, which are often handled in separate instruments. Particular areas of concern and complexity with regard to non-U.S. businesses are often the transfer of employees and benefits plans and the assignment of contractual rights and duties. Many countries' laws also require transferred assets and assumed liabilities to be enumerated and described in the transaction documents with much greater specificity than is typically the case for domestic U.S. acquisitions.

In addition, in transactions where numerous local subsidiaries of the parties are involved, one best practice is to utilize shorter subsidiary/local business transfer agreements in each jurisdiction in which business assets are changing hands under the auspices of (and subject to) the master purchase agreement. In addition to facilitating a smoother process to implement and consummate the local transaction, these are also helpful from a compliance and record-keeping perspective going forward.

Regardless of the choice of law, the buyer and its counsel should take care to draft representations and warranties suitable to the target's business, as that business has been revealed and illuminated by pre-acquisition diligence. After the diligence exercise itself, representations and warranties (or their functional local equivalent) are often the chief means by which the buyer will manage its potential liabilities and risk exposure arising from the transaction. Representations and warranties should also reflect jurisdiction- or industry-specific terminology and be drafted based on a thorough comprehension of applicable provisions of local law. In addition to traditional business risks, the evolving nature of business enterprises and of national legal frameworks have increased buyers' focus on representation and warranty coverage in such areas as anti-corruption, import/export regulation, data privacy, and the integrity and adequacy of IT systems.

Other Liability Pitfalls in International M&A

Technology firms seeking to make acquisitions abroad should also be aware of various other areas that enjoy well-earned reputations as ''liability traps'' for unwary investors. The list below is intended to be illustrative rather than exhaustive:

-Ownership: The failure to discover in time that a foreign target does not actually own its claimed IP rights can be very costly. Accordingly, the due diligence investigation must verify the existence of a clear chain of title from each and every inventor or prior owner, the proper filing of assignments, and the absence of liens or other encumbrances. The target's contracts with its employees and contractors must be reviewed to confirm that rights to inventions have been properly assigned. Joint development agreements with universities or other partners must be scrutinized to see how the use and ownership of created IP are addressed. If the target's technologies have been developed in part with public funding (in the form of government grants, loans, tax credits or otherwise), be aware that the associated IP rights may be subject to claims by, or reversionary rights in favor of, public authorities in the foreign country.

-Compliance: If not adequately managed, legal and regulatory compliance risks can have enormously costly implications for a buyer. Corporate misconduct by a target company, including activities such as fraud,

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bribery, collusion, money laundering and data privacy offenses, hold significant potential for loss of deal value, as well as potential civil or criminal sanctions under the FCPA and other domestic and foreign statutes. Compliance risks are often mitigated through such means as specialized forensic diligence, negotiated indemnities for identified risks, the exclusion of high-risk business activities from the transaction, purchase price adjustments, and post-acquisition audit and remediation.

-Labor: U.S. businesses venturing abroad should not be taken by surprise when encountering the highly regulated and extremely labor-friendly environment that prevails in many foreign jurisdictions. Other nations' laws often impose severe constraints on the ability to terminate workers and may grant continued employment rights, or impose substantial severance obligations, even in an asset acquisition. In some jurisdictions, works councils or similar employee bodies enjoy rights of consultation or even approval over certain corporate transactions. The prevalence and legal treatment of organized labor and collective bargaining agreements likewise vary widely from one jurisdiction to another. The majority of these and other employment-related issues can be addressed through early identification, local expert consultation and adequate document drafting and integration planning strategies.

-Pensions: The acquisition of foreign pension plans and their attendant liabilities in a cross-border M&A transaction can represent a substantial portion of the buyer's overall deal risk. Considerable variation in legal frameworks and valuation methods, as well as the specter of underfunded obligations, make pension issues a major risk management focus. These concerns are often heightened in the transactional context as ''change of control'' events can often triggering funding obligations. Thorough diligence, obtaining clarity concerning applicable accounting standards and actuarial assumptions, and negotiation of representations, warranties and post-acquisition plan administration and funding obligations are generally key to mitigating the buyer's risks here.

-Competition/Antitrust/Merger Control: Many cross-border M&A transactions must be notified to, and in some cases receive specific clearance from, competition authorities in multiple jurisdictions prior to closing. Coordinating the proper and consistent preparation of these filings can pose a logistical challenge for the parties and their counsel. Compliance can entail significant delays in deal execution or burdensome conditions such as forced divestiture. Noncompliance – including ''jumping the gun'' by completing a transaction without due notification – can invite substantial fines. International merger control issues can affect target valuation, purchase price and post-acquisition conduct of the business. Advance planning, liaising with relevant authorities and (where appropriate) exclusion of problematic countries or business units from the acquisition can aid in addressing potential merger control compliance issues.

Post-Acquisition Integration

It is by now widely-recognized by sophisticated multinational enterprises that successful post-acquisition integration is crucial to realizing the strategic benefits and anticipated synergies sought by M&A buyers. Yet in practice, failures in integration planning and execution remain among the chief reasons for unsatisfactory acquisition outcomes.

Integration is an ongoing, multi-stage and evolutive process. Typical integration focus areas include such diverse matters as foreign tax planning opportunities and the preservation of advantageous tax attributes; implementation of compliance frameworks; harmonization of information technology systems; consolidation of accounting, audit and reporting systems; sales and supply channels; customer retention; workforce integration; licensing and business registration formalities; and perfection of the conveyance of various assets.

Well-designed integration plans depend on insights and strategies developed in the pre-acquisition diligence phase. They are generally most effective when deal teams and integration teams work in close collaboration beginning well in advance of closing. While each integration plan is necessarily tailored to a specific target's business and local environment, successfully executed plans tend to follow a broadly similar approach: early risk identification, design and implementation of practical solutions, and the provision of ongoing support and monitoring.

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