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NAVIGATING CROSS-BORDER M&A TRANSACTIONS

Cross-border M&A transactions involve a host of legal issues that are either absent from domestic deals or are more complex in light of the multiple legal regimes and deal-making practices involved. Advance planning and strategic thinking are often necessary to successfully execute a cross-border M&A transaction.

The following is a checklist of critical issues and practice points that a buyer and its legal counsel may wish to consider when undertaking a cross-border M&A transaction for a privately owned target company:

- **Transaction Structuring**. While a share purchase is a universal method to acquire a company, a buyer also should consider alternative potential transaction structures taking into account local tax, government authorization, third party consent, and timeline requirements. The country where the target company is located also may have unique acquisition structures that could be particularly effective to assume control over the target company, so local advisors should be consulted at the outset of the transaction. For example, as an alternative to a business transfer arrangement under which key assets are cherry-picked for purchase by a buyer, Japanese corporate law offers a corporate split/de-merger scheme that enables a buyer to acquire specified assets and liabilities of a particular business segment by operation of law (thereby alleviating the need to obtain third party and employee consents in connection with the consummation of the acquisition).

- **Local Counsel Selection**. At the early stage of the transaction, the buyer should identify the key jurisdictions from where the target business is operated and retain appropriate local counsel.

  Factors that drive the selection of local counsel resemble the factors that impact counsel selection in a domestic transaction, such as competence and expertise, but in the cross-border context a greater emphasis should be placed on:

  (1) *Conflicts of interest policies*. Local bar rules can vary significantly from those in the buyer's home market. If not clearly expressed in the engagement letter, local counsel should separately disclose how conflicts of interest are determined, the use of advance conflict waivers, and what procedures are implemented (e.g., information barriers) if the local counsel seeks to represent a party opposite the buyer in an unrelated transaction.

  (2) *Billing practices*. Local counsel may have different hourly rates or fee structures depending on the nature of the transaction and the jurisdiction in which the client is located. If a buyer seeks "equal treatment," then a transparent fee scheme should be discussed upfront with local counsel to avoid misunderstandings.

  (3) *Liability caps*. While the bar rules in a number of jurisdictions prohibit monetary caps on professional malpractice (e.g., New York), other jurisdictions do have such limitations and local counsel may place liability caps based on a fixed amount, the amount of legal fees it receives in the transaction, or the extent of the firm's insurance coverage. Dealing with professional liability is key not only for the buyer retaining the local law firm, but also for the lead counsel if such law firm will combine the advice and due diligence findings of the local counsel teams into its due diligence report as it could be held accountable for the work product of the other firms (so it would behoove lead counsel to expressly indicate the responsible firm for each portion of a compiled report to avoid it from incurring umbrella liability).

  (4) *Clarity of communications*. If introductory emails or initial advice from local counsel is challenging to understand, then this difficulty should be viewed as a red flag and alternative local counsel may need to be selected.

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(5) *Experience*. The ideal local counsel is a firm with vast experience representing overseas clients and a sufficient depth of in-house resources. The local office of a global law firm may not be the best choice if it was established to service a particular client base or is geared to advise on a specific aspect of law or type of transaction (e.g., capital markets transactions). Without competent local counsel that recognizes the need to understand the objectives of the overseas buyer and its business practices, key issues can go undiscovered.

- **Foreign Investment Restrictions**. The buyer should consult with local counsel at the kickoff of the transaction to determine if there are statutory restrictions that prohibit the buyer from carrying out the acquisition as originally contemplated. Besides common restrictions on foreign direct investment in a country's military, utilities infrastructure, high technology sectors and natural resources, many countries recently have also placed significant foreign direct investment restrictions in the medical device and medical therapies areas, as well as in companies that hold sensitive personal data (among others). Some countries also restrict foreign ownership of real estate along the country's borders and coasts. Foreign investment regulations also can be heavily influenced by political considerations as these statutes are often vaguely worded and subject to executive oversight, so an overseas buyer may need to implement a comprehensive communications strategy if resistance is likely.

- **Due Diligence**. An overseas buyer should discuss with local advisors at the outset a due diligence roadmap for how key issues can be effectively covered, including which documents in the data room are considered within the purview of the legal advisors and which will be covered by other teams (e.g., business, finance, tax, HR, and insurance). Because the due diligence request list is often one of the first documents the target company receives, due diligence standards should take into account the local country's legal regime and diligence practices to reduce friction with the seller. The wholesale application of the buyer's home market due diligence standards can cause delay, waste time, insult the seller, and result in the buyer missing a key local issue. The overseas buyer also needs to make sure it is looking for the right issues. In Japan, for example, it would be a mistake to review only the employment agreements when modeling compensation terms because various other types of employee payments are often enumerated in a company's work rules. Attuned local counsel will ensure that the buyer's objectives are accurately captured.

Lead counsel coordinating a global due diligence exercise should adopt meticulous steps to foster ease of comprehension, accuracy and efficiency in the diligence reporting, such as:

(1) *Create guidelines so there is reporting conformity*. Local counsel should be provided at the outset with instructions for their due diligence reports, including scope of work, common defined terms, materiality thresholds, key document categories that require deep analysis (e.g., supply and distribution agreements), important provisions to summarize (e.g., change of control clauses, non-competes, and most favored nations grants), format of the report (e.g., a key issues list or a full due diligence report), and the reporting timeline (typically, a preliminary due diligence report followed by an updated due diligence report). Local counsel also should be made aware of the proposed transaction structure and the key reasons why the buyer wants to complete the transaction in order to avoid major gaps in the due diligence reports.

Lead counsel should determine (in conjunction with the buyer) whether the various legal due diligence reports should be delivered under separate cover by the various law firms or combined into a global legal due diligence report, balancing the benefit of having all of the legal due diligence findings in one document against the greater time and expense to prepare a global legal due diligence report. If separate legal due diligence reports are desired, then lead counsel should consider distributing a due diligence report template for the local firms to follow.

(2) *Confirm all material documents were reviewed.* Lead counsel should analyze the data room and assign document review responsibility across the law firm pool. While the governing law of an agreement can be used as a primary marker

to assign review responsibility, it should not be considered the sole factor as the place of performance also can impact the enforcement of an agreement (so more than one local counsel may need to review the same agreement). As documents are added to the data room, the lead counsel should send updates to the local counsel concerning review responsibility (unless the data room vendor automatically sends data room updates and it is expected that local counsel will review all of the documents involving its jurisdiction). Local counsel also should be instructed to identify in its due diligence reports the documents it reviewed so lead counsel can confirm that all of the pertinent legal documents in the data room were examined by counsel.

(3) *Consolidate certain matters with a single firm.* While local counsel will advise on various topics, there are certain matters that can be successfully handled by a single law firm due to the availability of public information and the finite scope of work. For example, it is common for an experienced law firm to undertake a global review of antitrust requirements, IP/trademark registrations, anti-corruption/FCPA compliance, and foreign direct investment restrictions.

- **Documentation Standards**. The parties should determine which documentation standards for the transaction documents will apply (i.e., those of the buyer's or the seller's home market) early in the negotiations as they can have a significant impact. Documentation standards are independent of the choice of governing law for an agreement, and derive from established market practice that can impact the style, coverage, conditions, and depth of the documentation. For example, in comparison to U.S. documentation standards, the indemnification provisions in Japanese acquisition agreements are relatively streamlined (even though the use of transaction insurance is uncommon) and contain far fewer representations and warranties and closing conditions. Not agreeing upfront on documentation standards can lead to frustration by the parties and possibly derail the negotiations if a heavy markup is returned by a counter-party. Often a fusion of the documentation standards of the buyer's and the seller's home market are adopted if each require board approval to complete the deal, which may require great finesse and patience from each side to reach the ideal balance.

- **Tax**. Many countries have unique taxing schemes, which could result in tax payments arising from a change of control of the target company or a transfer of assets. If the buyer is required to pay these taxes, then a restructuring of the transaction or a tax-sharing plan may need to be agreed with the seller. In the post-closing context, a buyer should become knowledgeable of applicable transfer pricing rules and taxes imposed in connection with transferring technology, trademarks, movement of personnel and the supply of services. The buyer also will need to consider how to efficiently extract money from the overseas business, which may require a multi-jurisdiction tax analysis and the layering of entities to benefit from international tax treaties.

- **Corporate Authority**. Understanding requisite corporate authority is necessary to help ensure an agreement is binding (and not merely an expression of intent). For a transaction party that operates in a common law jurisdiction, it is customary for it to represent and warrant that all necessary corporate approvals have been obtained and that the person executing the agreement is duly authorized to sign. Conversely, in many civil law jurisdictions, the local civil code establishes specific categories of grants of authority. An overseas buyer contracting with a counter-party based in a civil law jurisdiction should ensure that the appropriate person at the seller has executed the acquisition documentation.

  Similarly, it may be customary that a party's representative in charge of negotiating the deal may not be empowered to approve the deal. For example, under the predominant corporate governance structure in Japan, material decisions are normally decided by a company's Representative Director. Unless the seller is a large cap company, a party should be wary if its Japanese negotiating counter-part is not a Representative Director and claims to have binding authority to resolve outstanding issues on his or her own at the negotiating table, and may wish to condition its concessions on the assumption that certain counter-matters are also conceded.

- **Currency and Payment**. Cash is a common form of consideration in cross-border transactions,

with settlement typically in the local currency of the seller (unless there are currency controls or the seller is based in a hyper-inflation economy). The buyer's treasury department should examine currency conversion mechanics to ensure that the correct currency is available at closing in a tax and cost-efficient manner, including whether an inter-company loan or capital contribution is necessary to place the funds in the proper acquisition vehicle and in a convenient time zone so proceeds can be transferred by the closing time. Currency hedge agreements also may need to be purchased by the buyer depending on the size of the transaction. If it will not be possible for the buyer to transfer the purchase price to the seller by the closing time (e.g., the bank account from which the purchase price will be funded is administered in a country that does not have overlapping banking hours with the seller's bank), then the transaction parties should discuss a conditional sale-and-hold or other temporary escrow scheme.

- **Closing Formalities and Execution Style.** The manner in which closings occur can vary across jurisdictions. For example, in the Netherlands the transfer of shares in a BV or NV company requires a notarial deed executed before a Dutch notary. The purchase price is paid into a special notary bank account, and upon confirmation that the closing steps have taken place, the deed of share transfer is signed and the sale proceeds are distributed.

  Lead counsel also should consider (i) the local timeline to form a new subsidiary and remove/replace directors (if such actions are desired by the closing date), and (ii) whether pages need to be initialized and whether electronic signatures are recognized as binding. In Japan, it often takes approximately six weeks to form a new company, and reconstituting the board requires a series of documents to be signed (some of which need to be notarized) and some originals need to be furnished. Also, few Japanese companies use electronic signatures to execute agreements (even though they can be binding), and a "wet signature" is normally effected by placing an individual's registered seal impression on a document instead of signing by hand using script.

- **Business Integration**. A buyer should undertake a thorough review of the overseas country's labor laws to ensure its post-acquisition business model can be realized. For example, Japanese law does not recognize "at will" employment (which could require a buyer to make large severance payments if it seeks to reduce headcount), certain long-term agreements cannot be terminated even if the arrangement provides a party with early termination rights (which could impact a buyer's "synergy" plans), and an onerous employee non-compete likely will not be enforceable. In addition, the data privacy laws of countries can significantly differ. If a key value of the target company is the personal data it holds, then the buyer should understand how local laws will impact its ability post-closing to use such personal data and share such personal data with affiliates and third parties.

- **Dispute Resolution**. An overseas buyer may prefer not to resolve disputes arising under the acquisition agreement in local courts due to a perceived bias by local judges and juries against foreign buyers. An overseas buyer may find arbitration an attractive alternative to settle disputes so long as the principal assets of the seller are in a country that is a signatory to the United Nations Convention on the Enforcement of Arbitral Awards. If arbitration is selected, then the transaction parties will need to consider a neutral/convenient location as the seat of the arbitration (and one that does not have a history of overturning arbitral awards), the governing language of the proceedings, the number of arbitrators, and the arbitration rules to guide the proceedings.

- **Governing Language**. The choice of governing language is key. The ability of a party to document the transaction in its native language will allow it to quickly digest issues and easily frame the negotiations. In cross-border transactions where the parties do not share a common native language, English is often used given its perception as the preeminent international business language. A buyer should carefully consider a seller's request that the acquisition documentation be prepared in a language for which the buyer's deal team does not enjoy fluency, as the time and expense translating the acquisition documentation can significantly increase the buyer's expenses and lead to delays. If the buyer must accept a foreign governing language, then to save expenses it could instruct its counsel to prepare issues lists. Once all of the issues have been purportedly resolved, then the buyer could have the acquisition agreement

translated so it can confirm the accuracy of the deal. If the parties accept English as the governing language and elect local courts to resolve disputes (as opposed to arbitration), then it is conceivable that the local court will require a translation of the acquisition agreement into the local language (which could lead to new controversies).

- **Language and Culture**. The ability to communicate effectively is fundamental to the success of cross-border negotiations. Buyers that have project teams staffed with bilingual and bicultural members are likely to be more effective than a buyer that expects the overseas seller to follow the buyer's home market practices. Often a sensitive issue can be resolved not only by the words chosen and the substance of the proposed compromise, but by the manner in which it is raised and the stage at which it is discussed, taking into consideration local norms.

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Cross-border M&A transactions can be complicated and challenging in light of the varying legal, financial, regulatory, cultural and operational issues that come into play. While a number of the comparisons above make reference to Japanese laws and practices, the points should conceptually apply by analogy to a number of other jurisdictions too (making the list more broadly applicable).

The complexity and nuance of cross-border M&A transactions often requires a bespoke approach to deal making. Legal counsel who have deep experience in cross-border transactions can successfully navigate through multi-dimensional issues and develop practical solutions to achieve a client's goals.

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