Top 10 Issues for Cross-Border M&A and Strategic Investments in 2013

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A range of complex and often perplexing issues must be navigated in the effort to successfully complete any cross-border transaction. Experienced U.S. players in the cross-border transactions arena understand that, other than in defense sector and a small list of highly sensitive areas, most successful transactions are based on careful advance preparation, well thought-out strategies, and deal structures that anticipate likely issues and concerns. Many of these current legal issues (and other issues) must be identified early in the process and appropriately addressed—sometimes even overcome—in one fashion or another in order for any inbound or out-bound transaction to be successful today.

Following is a top ten list of important issues that should be considered in advance of the launch of any inbound or out-bound transaction by U.S. businesses. Of course, each cross-border deal is different and implementation of these issues will greatly depend on the facts, dynamics, scale and geographic scope of the particular situation.

1. **Political Considerations**. Identifying and evaluating the actual or potential political implications should be accomplished in advance of initiating any M&A or strategic investment transaction. This analysis should be as comprehensive as practical and must go beyond more obvious issues such as whether the target company is in a sensitive industry or is owned/financed by a foreign government. It is imperative that the likely concerns of federal, state and local government agencies, employees/unions, customers, suppliers, communities and other interested parties be thoroughly considered and, if possible, addressed strategically prior to any acquisition or investment proposal becoming known to the public. Many parties—other than the executive branch of the federal government in the applicable jurisdictions—have potential leverage (economic, regulatory, public relations, etc.) that can bear on a cross-border transaction.

2. **U.S Law Compliance**. Complying with U.S. law can be troublesome for non-U.S. entities during both the deal-making process and post-closing integration phase. This applies to private transactions as well as public deals. In private transactions, U.S. laws such as the Foreign Corrupt Practices Act can pose pre-closing due diligence disclosure issues or post-closing compliance obstacles for non-U.S. entities in many regions—particularly outside of the EU. Another example is a foreign target’s historical business activities that do not comply with U.S. export and sanctions laws. In cross-border public deals, disclosure/governance compliance regulations, SEC rules, the Sarbanes-Oxley Act and stock exchange requirements can present certain challenges for non-U.S. companies. The actual and potential impact of these compliance issues should be evaluated to ensure compatibility with home country rules and to be certain that the non-U.S. target will be able to comply. For in-bound public transactions, 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 that become subject to U.S. listing requirements.

3. **Cultural and Communication Obstacles**. Cross-border transactions—inbound or out-bound—present a unique set of issues that are compounded by the scale and geographic scope of the deal. Even in this age of instant communication, parties to the deal often come from divergent cultural backgrounds, have multiple language requirements, have different business practices, and are in distant locales. Overlooking these issues can result in a failed deal or unsuccessful business integration. Most cultural and communication obstacles to a deal are best addressed with early and consistent collaboration and partnership with local players whose interests align with successfully completing the transaction. Early recognition in the deal process of the breadth of these obstacles is vital. Over-communicating and persistent collaboration are the keys to success here.

4. **U.S. Attorney-Client Privilege**. The attorney-client privilege is one of the oldest tenants of the U.S. legal system and perhaps the most important evidentiary privilege in the US. It aims to protect confidential attorney-client communications that relate to legal advice from disclosure to third parties—including disclosure to the government. The
purpose of the attorney-client privilege is to promote full and frank communications between attorneys and their clients. This privilege is generally extended by U.S. courts to in-house counsel. However, in many countries the rules related to privilege are quite different. Failing to recognize the risks posed for cross-border transactions and developing appropriate strategies to protect sensitive information can be catastrophic. In cross-border transactions this privilege can be inadvertently waived—or be found not to even exist in many circumstances (this is especially so for in-house counsel who may work on a transaction but not be licensed in various foreign jurisdictions). Waiver of the U.S. attorney-client privilege in cross-border deals can often be avoided through careful preparation and the implementation of precautions including taking practical steps to protect communications with non-legal consultants, segregating sensitive information on IT systems, retaining appropriately licensed local outside counsel (particularly for government investigations or sensitive competition law matters), and keeping legal advice oral as opposed to emails in countries where in-house counsel privilege may not apply.

5. **Employment and Labor.** Labor and employment issues in cross-border transactions can be quite complex because of the differences in local jurisdiction requirements or customs and practices. The depth of challenges in this area can become compounded by the scale and geographic scope of the deal. Many countries severely restrict the ability to fire employees and local labor laws may also impact or regulate employee work hours and benefits including overtime, vacation and severance. For example, France does not recognize “at will” employment and, as such, the employer must provide each employee with a written contract and may only terminate the employee for cause. In Japan, long-held traditional local customs and practices based on the expectation of “lifetime employment” for employees were recently codified into statute. Chinese law stipulates the amount of severance to be paid to an employee terminated without cause. And, labor unions play a large role in Germany and union collective bargaining agreements typically define employee wages levels, work conditions and termination conditions. Overlooking these issues can result in an inadequately designed transaction structure, unforeseen liabilities or unsuccessful business integration after transaction closing. Most labor and employment issues are best addressed by early identification and well thought-out strategies.

6. **Tax and Accounting Considerations.** Tax issues are typically critical to structuring the transaction. Non-U.S. acquirers contemplating a dividend stream flowing from the U.S. target need to structure the transaction to deal with 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 indebtedness. For cross-border stock-for-stock mergers or acquisitions that are intend to be tax-free, special rules applicable to these kind of transactions may be relevant. Also, different countries have different accounting rules. Being aware of any significant difference between these accounting standards will minimize confusion between financial terms of a deal.

7. **Post-Closing Integration.** 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 who 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.

8. **Antitrust and Anti-Competition Issues.** To the extent that a non-U.S. acquirer 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 attorney general level. Although less typical, concerns can also occur if the foreign acquirer competes either in an upstream or downstream market of the target. Pre-closing planning integration efforts should also be sensitive to antitrust considerations.

9. **Transaction Structure.** A variety of potential transaction structures should be considered when developing the deal structure, especially in sensitive transactions. Choosing the right deal structure is often critical to successfully closing the transaction and optimizing post-closing integration and operations. Structures used successfully on past deals have their place, but today other structures can be helpful in many circumstances. Examples of these deal structures include no-governance and low-governance investments, minority ownership stakes or joint ventures (with the potential for
future increase in ownership or governance over time), making an acquisition in partnership with another firm or co-investor, or for foreign acquisition of a U.S. business, utilizing a controlled or partly-controlled U.S. acquisition vehicle.

10. **Due Diligence.** Wholesale application of the acquirer’s domestic due diligence standards to the target’s jurisdiction can cause delay, waste time and resources, or result in missing key issues. Due diligence methods must take into account the target jurisdiction’s legal regime and, particularly important in a competitive auction situation, take into account the local customs and practices. Making due diligence requests that appear to the target as particularly unusual or unreasonable (not uncommon in cross-border deals) can easily cause a party to lose credibility. Similarly, missing significant local issues for lack of target country knowledge can be highly problematic. These issues can be typically addressed by engaging and soliciting input from experienced local counsel.

**Conclusion**

This top ten list is, of course, not exhaustive of all possible issues as no two deals are ever exactly the same. Similarly, the issue order is not meant to establish any particular priority among these issues as every deal has its own priorities and dynamics. There are many other potential issues and traps for those involved in cross-border transactions. Identifying and addressing the issues on this top ten list, as well as the many other issues not on listed here, will certainly aid in closing a successful deal.

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