FOREIGN INVESTMENT

Top Legal Issues for European Clients Targeting a U.S. Acquisition

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As global markets have steadily improved, more European companies use their cash reserves and equity balance sheets to acquire strategic targets at attractive prices. The majority of these targets are based in jurisdictions outside of the European Union (EU) and particularly in the U.S. With international mergers and acquisitions becoming standard – even for middle market companies – acquirors must realize that a range of complex issues arise in a cross-border transaction. This article is structured to discuss some of the legal issues that arise during all stages of a transaction: (i) the pre-acquisition, (ii) acquisition, and (iii) post-acquisition phases. Senior management and their project teams need to be proactive and to implement strategies that can mitigate potential pitfalls to ensure the successful execution of a cross-border acquisition deal.

Federal and State Law Distinctions Matter

The U.S., with its stable political climate and well-developed regulatory landscape, continues to be a key market for European companies that seek to expand their core businesses or diversify their portfolio holdings. A federal republic of 50 states with Washington D.C. (a federal district serving as the nation’s capital), the legal system is divided into state and federal law. Federal law, applied uniformly across the U.S., is the supreme law of the land and it pre-empts state law where a conflict arises between state and federal law. Each state’s laws generally apply only within its borders but are applied across borders in other states under the U.S. Constitution’s Full Faith and Credit Clause (Article IV, Section 1). The significance of this distinction is important to understand for the European investor when setting up a business. For example, entrepreneurs frequently select as popular choices of business entities either a limited liability company (LLC) or a corporation – both of these entities are creatures of state law with varying operating characteristics. Federal laws generally do not govern corporate formation or mechanics, however, securities laws in the U.S. are governed by both federal and state law (also known as “Blue Sky laws” for state securities laws). Additionally, the federal tax characteristics of such business entities are a major consideration when setting up a business or acquisition vehicle. European investors are able to rely on the U.S. judicial system which functions transparently, efficiently and, for the most part, very consistently.

The U.S.: A Historic Target for Foreign Direct Investment

For decades, the U.S. has served as a beacon for foreign investment and business opportunity. Not surprisingly, by global standards, it is still considered by international investors as one of the most attractive and saf-
est investment destinations. Such long-standing stability explains the steady increase in foreign direct investment through mergers and acquisitions before and after the financial crisis. Despite the lingering economy stemming from the worldwide financial crisis, Europeans have invested typically in a wide range of U.S. industries during 2008-2014 such as biotechnology and information, media, banking and the manufacturing sector.

The federal government imposes few restrictions on foreign investment. A few industries are, however, subject to certain restrictions – these include the exploitation of natural resources, computer technology, communications, transportation, shipping, nuclear and other power-generating facilities, and aviation. Another example is the acquisition of agricultural land by foreigners – this area is restricted by states, and the federal government imposes substantial reporting requirements for foreign investments.

**The Pre-Acquisition Phase – Legal Due Diligence**

When acquiring a U.S. company, it is important that a European company conducts a thorough investigation into the affairs of the U.S. target to understand the target’s business and the environment in which it operates – often referred to as the ‘due diligence process.’ While there are many types of due diligence that a potential acquiror may undertake – financial, technical, commercial – it is likely that a European company will find U.S. legal due diligence challenging, as there are many aspects in which U.S. laws provide the setting for risk mitigation that are unfamiliar to a first-time European buyer. One area of added complexity, for example, is where a U.S. target is subject to regulation both at the federal level and at the state and other local levels. While there is generally little risk that these layers will contradict each other, it is worth remembering that a review of federal regulations that apply to a U.S. entity is not exhaustive, and does not provide a complete picture of the legal risks that a U.S. entity faces (e.g. environmental laws). Certain industries, such as computer technology, are also subject to additional regulation, potentially at both the state and federal levels, and which may be unfamiliar in the European law context.

Another complexity occurs when U.S. laws impose liability on successors to existing businesses, even if an acquiror of a business might attempt to avoid the assumption of such liabilities by contract, e.g., structuring the transaction as an asset purchase sale. Strict successor liability, regardless of contractual exclusions, will sometimes arise in areas such as employee benefits or environmental responsibility. Finally, the significance of a third-party claim against a U.S. target – whether threatened or asserted within a judicial or arbitration setting – may be different in the U.S. due to any number of reasons including: (a) the stage or circumstances of the proceeding, or (b) a statutory limit or enhancement of potential damages.

Understanding the full complement of legal risks when acquiring a U.S. target requires advisors who are well-versed in the legal context in which a U.S. business operates. Most U.S. transactional lawyers are typically well-experienced and knowledgeable to protect their acquiring clients from such legal risks as they enter into transactions with U.S. entities, and assist their clients to assess such risks when full protection is not feasible.

**Litigation and Other Risks**

Another important difference between the EU and the U.S. regulatory regimes is that EU manufacturers have strict liability for product defects. However, damages for product defects in the EU are generally capped, and plaintiffs in Europe do not have the luxury to pursue distributors or retailers for recovery. Additional hurdles to a company’s risk of substantial loss in such cases exist in Europe, including the absence of percentage-based contingent fee arrangements with law firms which might front the needed expenses to pursue costly litigation, and the adoption of the “English Rule” by the EU where the loser pays the winner’s attorney fees. Such restrictions are not common in the U.S. – punitive damages are available, jury trials are routine, and generally there is a greater expectation of recovery on strict liability claims in the U.S., leading U.S. companies to be far more willing to settle claims out of court rather than resort to expensive defensive litigation.

The availability of contingent fee arrangements with lawyers, jury trials and generally uncapped awards, and the general inability of corporate defendants to recover attorneys’ fees from plaintiffs who bring losing suits against them, are characteristics of litigation cases within the U.S. This means that even more routine claims, such as those based on employment disputes, commercial matters or minor torts, can be more costly than in Europe.

None of this necessarily means that enterprise-level strategic business decisions need to be changed, but the existence of such potential claims needs to be valued differently in the U.S. than it does in Europe. Such claims represent, to some extent, additional operating costs rather than pure contingencies. In addition, within particularly litigious settings, the operator of a business in the U.S. is obliged to pay more attention to the implementation of risk management techniques, such as requiring mandatory mediation or arbitration, where permitted, with commercial parties, or spending more administrative resources on policing employee policies and conducting internal employee training to reduce the risk of employee claims.

Other examples where legal risks and costs are significantly different between the U.S. and Europe, include the costs of adhering to federal regulations that require either significant reporting requirements – such as the detailed disclosure and corporate governance regulations for public companies required by the federal Securities Act of 1933 and the Securities Exchange Act of 1934 – and the high costs associated with obtaining certain regulatory approvals, such as the U.S. Food and Drug Administration approvals for pharmaceutical products.

**Successor Liability**

As mentioned, sometimes a buyer of a business may be liable for the target’s liabilities, even if the acquisition contract did not provide for or even specifically exclude such an assumption of liabilities. In stock acquisitions and mergers, of course, the acquiring or surviving entity typically steps into the shoes of the target assum-
ing all assets and liabilities, and the only way for an ac-
quirer to mitigate liability exposure in such situations is
to provide contractually for indemnification of the costs
of such liabilities by the sellers. Since sellers often dis-
appear after the transaction is completed, and the pro-
cceeds of the sale may end up being widely distributed,
acquirors in the U.S. typically will attempt to negotiate
for holdbacks or escrows of a portion of the sale consid-
eration to secure collectability on indemnification claims.

In asset transactions, the parties are generally free to
contract specifically which party shall assume or retain
a liability of target – but there are exceptions. In some-
what rare scenarios, courts may in hindsight review a
transaction and conclude that it is, for purposes of as-
signing liabilities, a “de facto merger,” or that the sur-
viving or acquiring entity is a “mere continuation of the
seller entity.” Each of these conclusions, however, re-
quires the existence of various factors, including some
continuity of ownership with the target (where, for ex-
ample, an acquirer pays for the assets with the stock of
the acquiror), or where the acquiring entity has a com-
mon identity of officers, directors and shareholders
with the target.

In an asset purchase deal, European companies are
familiar with employment scenarios where employees
and employment-related liabilities are transferred to
the buyer in the event of a business transfer. Accord-
ingly, even in an asset acquisition, the buyer automatic-
ally assumes all employees and related liabilities of the
target business. The parties cannot modify these statu-
tory consequences of a business transfer in the acquisi-
tion agreement, although they can allocate the risks and
liabilities among themselves.

Employment-related liabilities are treated in a much
different manner in U.S. asset purchase deals since em-
ployment relationships are generally terminated and
new offers are extended to all or selected employees.
However, there are other areas under U.S. employment
law in which the European acquirer of a U.S. business
may unwittingly assume the liabilities of the target.
Such situations typically arise, for example, in the em-
ployment benefit plan area. Pension liabilities, such as
minimum funding obligations, are the obligations of a
buyer of assets based where there is a continuity of
business operations, and where the buyer was aware of
the existence of the liability before the transaction.
In the area of labor regulation, where an acquirer buys the
assets of a business in which there exists a labor union
collective bargaining arrangement, the U.S. National
Labour Relations Act requires the acquirer to negotiate
with the union in good faith. Unless the buyer is found
to be an “alter ego” of the seller due to extenuating cir-
cumstances, however, there is no obligation that the
buyer needs to submit to the terms of the seller’s collec-
tive bargaining agreement with the union.

Similar situations sometimes arise in asset deals as-
associated with federal or state tax liabilities. Although
a tax liability is generally only the liability of the selling
entity, a tax lien for unpaid taxes is effectively attached
to the assets being sold, so that the acquiring entity can
be viewed as liable for seller’s unpaid taxes with the as-
sets in question.

The Equity Ownership Records of Private
Companies

Privately-held U.S. companies do not normally have
a public shareholder record. This can be confusing for
European investors, because in many European juris-
dictions (for instance, in Germany) every share transfer
is authenticated by a public notary and registered with
a governmental or judicial body (in Germany, the “Han-
delsregister”). This system of public recording of
share transfers ensures that there is a publicly available
record that evidences the ownership of a company. In
the U.S., publicly-traded companies – companies with
shares registered with the SEC and traded on ex-
changes or in over-the-counter public markets – inde-
pendent “stock transfer agents,” contracted by the
company act as commercial share registries; their rec-
dords are normally not available for public scrutiny, ex-
cept under rigid guidelines, but a public target can
make these records available to a potential acquiror.

The U.S. system is completely different for privately-
held companies, however, in that it relies exclusively on
the records of the target company and/or the records of
its shareholders in order to establish the ownership of a
company’s outstanding shares. In privately-held com-
panies where the number of shareholders may be in the
dozens, a buyer will typically need to spend additional
resources on due diligence to ensure that the capitaliza-
tion information provided by the target company is ac-
curate. Board minutes authorizing issued shares must
match the number of outstanding shares and stock cer-
tificates and transfer records must be checked. Even
then, there is no guarantee that the shareholder infor-
mation provided is 100% accurate. To protect a buyer
against potential claims raised by unknown shareholders
who come out of the woodwork months or years af-
afer a corporation acquisition transaction has closed, it is
important for the acquisition agreement to provide for
strong share title representations and indemnities. In-
demnification for breaches of such representations
should not be subject to survival periods, baskets, caps
or other indemnification limitations. This can easily be-
come a trap for the unwary European buyer who is used to
relying on a public shareholder registry for all com-
panies.

The Acquisition Phase

Letters of Intent/ Term Sheet

Most deals typically begin with the negotiation of
terms between the potential buyer and seller over the
substantive terms of the transaction. In the U.S., it is
customary for the parties to negotiate and generate a
term sheet or letter of intent (LOI) which summarizes
and outlines the most important terms of the acquisi-
tion. The securities status of the U.S. target – whether
or not the company has a class of securities which are
publicly registered and listed with a U.S. based stock
exchange – will normally determine if the LOI is bind-
ing or non-binding. It is typical for a privately held com-
pany to enter into a non-binding LOI (except for nondis-
closure, confidentiality and non-circumvention provi-
sions). This is because the two parties are usually still
exchanging due diligence material or have yet to even
start the due diligence process, the terms of which are
often governed by the LOI. Conversely, in the acquisition of a public company, most material information is filed with the U.S. Securities and Exchange Commission. Accordingly, LOIs are often binding and may contain large break-up fees if the buyer walks away from the transaction. In addition to any confidentiality clauses that may be part of the LOI, parties often enter into a separate confidentiality agreement. The acquisition target (normally the primary disclosing party) may be sensitive toward the risks of disclosing highly sensitive information (formulas, technical specifications, customer lists, current litigation, etc.) to the buyer. Misuse by the party who receives the information can cause irreparable economic and business damage. The disclosing party can protect highly sensitive information by using a two stage disclosure process detailing the most sensitive information after the execution of the definitive acquisition agreement.

Because private companies’ material financial and other legal information are usually fully undisclosed in the public domain, the term sheet needs to be non-binding or contain a minor break-up fee so that the parties may “walk away” from the transaction if they discover any information that would cause either side, respectively, to sour on the proposed deal and refuse to complete the process. One exception to the non-binding LOI in the private company context is if the LOI or term sheet arrives after an auction process where the buyer or investor has already had a chance to complete much or most of its due diligence.

Transaction Structures
Transaction structures are driven by control, valuation, tax, accounting, reporting, corporate, management, employment, organized labor and/or collective bargaining and other considerations. Transaction structure must take into account numerous factors of the proposed transaction including the following:

- What kind of legal business entities (C corporation, S corporation, partnership, LLC) or natural persons will be involved in the transaction and, if a business entity, who are the owners of the business entities?
- If the deal is a purchase transaction, should the transaction be structured as a merger, stock purchase or asset purchase deal?
- Where are the business entities participating in the transaction organized/incorporated and where are such entities based or operating from?
- What will be the resulting tax treatment of the transaction - taxable versus non-taxable? Depending on the type of business entity acquired there may be a step-up in basis capital account (e.g. S-corporation, LLC or limited partnership) as well as state tax issues which are separate from the federal tax treatment. Tax issues are often times material enough that tax ramifications will need to be determined and agreed upon before much of the transaction is completed.
- In a complex deal, is more than one step required to complete the deal (e.g. completion of bank or other third party financing prior to the completion of the acquisition agreement) and what should be the sequence of the underlying transactions?
- If third party financing is involved, what are the requirements of the financing party? Private equity, hedge funds and banks may be more comfortable with certain structures over others.
- How do you manage the transaction logistics? (assembling required team members, processing of due diligence information, state and federal filings, public relations and press releases.)
- Liability management as a result of the acquisition structure (stock purchase vs. asset purchase).
- Selection of assets in an asset purchase (Will there be any excluded assets? Are there any licensing issues associated with the industry of the target business? Are there any barriers or required permissions for transfer of any licenses?).

In addition to post-closing regulations which an EU business may be unfamiliar with, acquiring parties must be aware of regulatory compliance during the transaction. Considerations before or during the transaction may include, securities filings, anti-trust rules or licensing issues for a particular industry.

The most common types of acquisitions are purchases of (i) the target company’s stock, (ii) the purchase of all or substantially all of a business’s assets, or (iii) statutory mergers. However, it is increasingly common for EU based businesses to use joint ventures with the U.S. target to establish the desired business combination.

A stock purchase involves the purchase of all or a majority of outstanding equity securities directly from company stockholders. Stock purchases are the most common form of structure in the acquisition of private companies or wholly-owned subsidiaries. The acquisition of all or a majority of stock makes it difficult to exclude certain liabilities or assets (liability generally follows as a matter of state law). As mentioned above, there can be a number of minority shareholders who refuse to take part in the transaction and who may cause issues during the transaction and the post-acquisition. Depending on the state and the level of their stock holdings, minority shareholders can sometimes be frozen or merged out. Stock purchases do have the advantage to dispense with re-titling company assets.

In an asset purchase transaction, the buyer only purchases the assets and liabilities that are identified in the asset purchase agreement. The seller retains equity interests of the entity that holds the corporate assets and the buyer will utilize an already existing entity or create a new one for the purpose of acquiring the assets. Any assets or liabilities that are not identified as being purchased will continue to be owned and reside with the seller’s business entity. Because of this ability, asset purchases are also commonly used when the seller is in a distressed financial condition or is being used to sell assets after the business declares bankruptcy.

A merger between two or more companies is a state regulated process in which one company continues to legally exist, while all others cease to exist. For example, in a two party merger, if Company A and Company B merge, Company A will continue to exist under its own name, while Company B will cease to exist under the terms of state law and begin to operate under Company A’s name. A statutory merger is a commonly used acquisition method. Mergers are often used when

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1 See e.g. Title 8 of the General Corporations Law of Delaware, Subchapter IX, Merger, Consolidation or Conversion.
the transaction is done without the merger causing taxable realization of income under the U.S. Internal Revenue Code and, similarly, under the pertinent state(s)’ tax laws where the target and surviving entity operate and are organized (commonly referred to as a tax-free merger or reorganization). There are various merger forms - straight or direct merger, forward-triangular merger, reverse-triangular merger, short form merger, etc. - that can be employed in an acquisition. The desired operational and governance control and tax aspects will determine which type of merger is best for the transaction.

As a direct result of the U.S. and worldwide financial crises, joint ventures are increasingly the instrument of choice for many EU business entities who want to gain a foothold in the U.S. market. The term “joint venture” or “JV” covers a wide array of arrangements but the term generally applies to any business arrangement in which two or more parties agree to pool their resources for the purpose of accomplishing a specific task or the operation of a jointly controlled business. The task can be single project or an ongoing business activity. A joint venture can be contractual in nature and responsibilities born directly by the joint venture partners or involve the establishment of a new business entity which will operate the business of the joint venture. Depending on the type of business operation, the joint venture partners will determine if the new business entity will have employees or if it will be run by the employees of the JV partners (a populated joint venture vs. an unpopulated joint venture). JVs commonly use LLC’s and partnerships if a new entity is established due to their pass through tax treatment. The new found popularity of JV’s is a direct result of the flexibility, private nature and, in many cases, reduced regulation that JV’s can operate in when other acquisition structures are subject to increased review and regulation.

The Negotiation of the Definitive Agreement

Whether the structure is a merger, stock purchase, asset purchase or joint venture, the finalization of the transaction will depend on one or more definitive agreements. Once the buyer is satisfied that the due diligence information it received is consistent with or is superior to its assessment of the business, the acquisition will be negotiated and entered into. There are common aspects which will be contained in most definitive and ancillary agreements regardless of the form structure:

- Purchase price, form of consideration and exchange ratio (if U.S. dollars are not being used).
- Escrow of purchase consideration (if applicable).
- Amount of investment or budget (JV Agreement).
- Legal structure of the transaction (e.g. use of holding company, acquisition entity or determination of merger form).
- Tax treatment of the transaction.
- Excluded assets or liabilities (asset purchase).
- Management of the business post-closing.
- Treatment of equity securities received or exchanged (merger or stock purchase).
- Representations, warranties, buyer and seller covenants and conditions to closing.
- Management and employee compensation.
- Confidentiality, no-shop, break-up and non-circumvention clauses.
- Non-competition clauses.
- Purchase price adjustments and earn outs.
- Indemnification provisions.
- Transaction expenses (attorneys, accountants, investment bank, etc.).
- Term and termination of the agreement.
- Governing legal jurisdiction.

Though there are mostly similarities, EU buyers may find themselves unfamiliar with some of the common aspects of U.S. acquisition agreements or required approval procedures for the transaction. For example, while it is not unusual for a collar adjustment to be placed on the purchase price of the U.S. target (setting limits on upward or downward fluctuations in purchase price), purchase price collars are not yet commonplace in EU transactions. Additionally, it is common for boards of directors of U.S. companies to approve not only the resulting transaction after negotiation but also to give their approval for their management to enter into discussions for such a material transaction. Required board and/or shareholder approval in the U.S. can also differ depending on the transaction structure. State laws require approval in many merger and stock purchase contexts while asset purchases and joint ventures may not require approval in their jurisdiction usually depending on the materiality to the selling company. And, as mentioned previously, there are numerous differences between how management and labor are treated in the EU versus the U.S. in an acquisition transaction. For instance, while there are labor unions and collective bargaining in certain states, other states are “right to work” states and there are no company work councils in any U.S. jurisdiction.

Another difference between EU and U.S. acquisition agreements is that many U.S. agreements have a “material adverse event” provision which, until recently, was absent in EU based purchases. This condition allows a buyer, or sometimes a seller, to walk away from the deal if a material adverse event occurs for one of the parties.

There are some important factors to remember in the broader context. Every transaction is different and cross-border deals involving EU and U.S. parties often includes very established views of deal character and form that vastly differ in the buyers and seller’s jurisdiction.

2 A “right-to-work” law is a statute in the U.S. that prohibits union security agreements, or agreements between labor unions and employers that govern the extent to which an established union can require employees’ membership, payment of union dues or fees as a condition of employment, either before or after hiring. “Right-to-work” laws do not provide a general guarantee of employment to people seeking work, but are a government regulation of the contractual agreements between employers and labor unions that prevents them from excluding non-union workers. Baird, Charles W. “Right to work before and after 14 (b).” Journal of Labor Research 19.3 (1998): 471-493.
tions. These differences can create at times early friction, undue emotion and incorrectly shape the view of each of the respective opposing parties. The form, length, conditions and the initial negotiation points in the first drafts of the acquisition agreement can frequently cause disagreements and hasty judgments. The acquisition team should know and understand what the various document standards look like in the buyer’s and seller’s markets and any differences should be highlighted before drafting the documents.

Navigating the U.S. Regulatory Framework

Understanding the regulatory framework and complying with U.S. laws is a top concern for executives involved in deals. The following are a few of the most material laws that impact public and private companies.

Publicly-traded corporations in the U.S. are companies whose shares trade on listed exchanges or in over-the-counter markets. Such trading may generally only be accomplished in compliance with the Securities Exchange Act of 1934, which requires the preparation and filing with the U.S. Securities and Exchange Commission (“SEC”) of quarterly and annual reports on the financial condition of the company. The classic method by which a corporation becomes a publicly-traded company is by “going public” through a highly-regulated sale of its stock to the public, i.e. to a widely distributed group of buyers provided a registration statement is filed and a statutory prospectus is delivered contemporaneous with the transaction. Such sales are generally regulated by the Securities Act of 1933, which requires the preparation and filing of a selling prospectus for pre-approval by the SEC. These rules and regulations are meant to protect the average consumer from buying shares on the public markets without the availability of true, correct and complete financial and business information about a company.

Privately-held corporations, on the other hand, operate largely “under the radar.” Their shares cannot be traded in public markets because such companies are not required to disseminate regular financial and business reports; such companies generally cannot sell their shares to a widely distributed group of buyers, and they generally cannot disseminate a selling prospectus to the public. Instead, through exemptions from the highly regulatory framework of the federal Securities Acts, privately-held companies are usually held by fewer than 300 shareholders, and have limits on their ability to raise equity capital. Although privately-held companies are limited in raising equity capital without further regulation, they can avoid disclosing information about their finances and operations to the public at large.

Due diligence on publicly-traded companies, therefore, is somewhat easier than it is to conduct due diligence on privately-held companies, since public filings by publicly-traded companies (such as the annual report on Form 10-K, quarterly reports on Form 10-Q, and the company’s annual proxy statement) provide a good road map to learning about the risks and potential liabilities associated with a company. The reliability of such public reports is in part ensured through relatively recent legislation. The federal Sarbanes-Oxley Act of 2002 (also referred to as “SOX”) sets governance and audit standards for all U.S. publicly-traded company boards, management and public accounting firms. The Act, enacted in response to a number of corporate and accounting scandals that shook investor confidence in the U.S. securities markets, targets three principal areas. First, SOX requires that the top management of a company must now individually certify the accuracy of financial information, and suffer individual accountability for the failure of the information to be accurate. Second, the Act imposes severe penalties for fraudulent financial activity. And finally, SOX increased the independence of outside auditors who review the accuracy of corporate financial statements while increasing the oversight role of independent members of the boards of directors of publicly-traded companies.

Acquiring a publicly-traded company in the U.S. is a highly regulated activity in and of itself. Although it is possible to acquire a controlling block of shares of a publicly-traded company through a private, negotiated purchase from a controlling party, acquirors must be careful to avoid triggering the tender offer rules, which involve making public filings with the SEC, including a formal disclosure document by which an acquirer makes an offer to all shareholders for the purchase of their shares. European companies who wish to acquire significant percentages of the outstanding stock of publicly-traded companies – even as little as 5% in open market purchases – must know that they may be required to make public filings associated with those purchases.

The Foreign Corrupt Practices Act

The Foreign Corrupt Practices Act ("FCPA") of 1977 is a U.S. federal law with two principal components: (i) the anti-bribery provisions which prohibit individuals and businesses from bribing foreign government officials in order to obtain or retain business and (ii) accounting provisions which impose certain record keeping and internal control requirements on issuers. This legislation, broad in scope and not a new development, gained increased momentum over the years because of increased reporting of bribery and kickback by some of the country’s most prominent corporations and the enforcement actions brought against them by the criminal division of the Department of Justice – violations of the act often result in hefty civil and criminal penalties including imprisonment. The goal of the FCPA is to ensure that American corporations play by honest rules thereby restoring public confidence in the integrity of the market place. The key considerations for the European client are: (i) who is covered by the act, (ii) the circumstances which trigger its application under the anti-bribery provisions and (iii) successor liability.

The anti-bribery provisions apply to three categories of persons and entities: (1) “issuers” and their officers, directors, employees, agents, and shareholders; (2) domestic concerns and their officers, directors, employees, agents and shareholders; and (3) certain persons and entities, other than issuers and domestic concerns, acting while in the territory of the U.S. For FCPA purposes, an issuer is a company that lists its securities on a national securities exchange in the U.S., or any company that is required to file periodic reports with the SEC. A company need not be a U.S. company to be an issuer and foreign companies listed on the U.S. exchange are also issuers, so that includes European companies.

The FCPA’s anti-bribery provisions targets conduct both inside and outside the U.S. U.S. issuers and do-
mestic concerns including their officers, directors, employees, agents or stockholders risk prosecution if they use the U.S. mails or any instrumentality of interstate commerce in furtherance of a corrupt payment to a foreign official. The act defines interstate commerce as trade, commerce, transportation or communication among the several states or between any foreign country and any state. But the act goes beyond interstate commerce and also covers cases where a foreign national attends a meeting in the U.S. that furthers a foreign bribery scheme – they would be subject to prosecution along with any co-conspirators. Additionally, if a foreign national or company acts as an agent of an issuer or domestic concern – here, too, the foreign company is liable for prosecution under the FCPA regardless of whether the foreign company itself takes any action in the U.S.

As a general legal matter, when a company merges with or acquires a majority of the equity of another company, the successor company assumes the predecessor’s company’s liabilities. Successor liability applies to civil and criminal liabilities and FCPA violations are not an exception. If a U.S. corporation violates the anti-bribery provisions of the FCPA before its acquisition by a European company, successor liability does not impute to the European corporation because the FCPA does not apply retroactively. It would, however, apply if the violations materialized during the pre and post-acquisition phase. Similarly, if an issuer acquires a foreign company that was not previously subject to the pre-acquisition phase. Similarly, if an issuer acquires a foreign company, the successor company assumes the predecessor’s company’s liabilities. Successor liability applies if the violations materialized during the pre and post-acquisition phase. Similarly, if an issuer acquires a foreign company that was not previously subject to the FCPA before its acquisition by a European company, successor liability does not impute to the European corporation because the FCPA does not apply retroactively. It would, however, apply if the violations materialized during the pre and post-acquisition phase. Similarly, if an issuer acquires a foreign company, the successor company assumes the predecessor’s company’s liabilities. Successor liability applies if the violations materialized during the pre and post-acquisition phase. Similarly, if an issuer acquires a foreign company, the successor company assumes the predecessor’s company’s liabilities.

The Committee on Foreign Investment in the United States (CFIUS) is an inter-agency committee in the U.S. federal government chaired by the Secretary of the Treasury. The U.S. national security review process is conducted pursuant to the Exon-Florio Amendment to the Defense Production Act of 1950, as amended by the Foreign Investment and National Security Act of 1970 (FINSA). The act authorizes the President of the U.S. to suspend, block or modify select transactions prior to closing that result in foreign control of U.S. businesses if such control threatens the national security of the U.S. It also authorizes the President to seek divestment or other relief in the case of concluded transactions. It is voluntary to file with CFIUS and the review is confidential – any information received by the agency will not be disclosed. The CFIUS review process begins with a joint submission of a voluntary notification by the parties. The receipt of a properly prepared notice triggers the initial thirty (30) day review of the transaction. At the end of the thirty (30) day period, CFIUS either clears the transaction if it is not a threat to the national security of the country or an additional forty-five (45) day review begins where the following criteria are determined: (i) the transaction could threaten national security and that threat is not mitigated, (ii) the transaction results in foreign control of a U.S. business by a foreign government or (iii) the transaction results in foreign control of U.S. critical infrastructure and impairs national security. If at the end of the forty-five (45) day period CFIUS is unable to determine whether the transaction is a threat to national security, then it must refer the matter to the President of the U.S. who has fifteen (15) days to permit, block or unwind the transaction.

The national security review may play a critical role in a cross-border transaction, even though it remains voluntary. Over the years, CFIUS review has gained increasing importance especially if the investments are in sensitive industries such as technology and infrastructure. Other industries in which notifications under the regime are submitted include computers, network security, cyber systems, energy, aerospace, telecommunications, steel, automotive, optics, robotics and semiconductors.

The Hart-Scott Rodino Act

The Hart-Scott-Rodino Antitrust Improvements Act of 1976 requires each party to an acquisition of (i) voting securities, (ii) interests in non-corporate entities (i.e., partnerships and limited liability companies) and assets meeting certain dollar thresholds (which includes a minimum transaction value that must exceed US$75.9 million), to file a Notification and Report Form (the “Report Form”) with both the Federal Trade Commission (the “FTC”) and the Department of Justice (the “DOJ”). After filing a pre-merger notification, the parties are subject to a mandatory waiting period during which time they may not complete the proposed transaction. The statutory waiting period is fifteen (15) days for cash tender offers and thirty (30) days for other reportable transactions. If the enforcement agency requests additional information before the initial waiting period expires, the waiting period will be extended to determine whether the proposed transaction violates the anti-trust laws of the U.S. or may cause an anti-competitive effect in the parties’ markets. The extension is 10 days after the parties comply with the request for cash tender offers and 20 days after compliance with the request for other reportable transactions. The penalties for failing to comply with HSR can be severe – ranging from monetary penalties to rescission of the transaction.

Two essential points for European clients on Hart-Scott Rodino: first, the FTC and DOJ have demonstrated that HSR compliance is an enforcement priority – because of this it is very important that parties to a merger act cautiously and make sure that they comply. As previously noted, the FTC and DOJ are pretty vigorous in their enforcement actions, so any attempt to structure a transaction for the purposes of avoiding an HSR filing or being grossly negligent in failing to observe the HSR filing requirement – those actions are not recommended. Second, when parties file they must make sure that they describe the proposed transaction and that they disclose their financial information including any various planning and evaluation documents. Item 4(c) and 4(d) of the HSR form requires the submission with the initial filing of any documents prepared by or for officers or directors that analyze the proposed transaction in terms of competition and market share whether prepared internally or by external advisers. Recently, the FTC announced major changes to disclosure requirements for Hart-Scott Rodino Notification Rules and Form that parties to certain transac-
tions must submit under the HSR. While these amend-
ments decrease the burden of reporting, they increase
the burdens in other areas. Briefly, those amendments
include the introduction of the concept of “associates”
which requires disclosure of managed entities and revi-
sions to the revenue data that parties are required to re-
port.

The Post-Acquisition Legal Issues

Once the acquisition is completed, the difficult as-
pects of the acquisition surface. In addition to the track-
ing of post-acquisition agreement terms and conditions,
there are many other items that the European buyer
should pay attention as they start the integration of the
new U.S. company.

Any required licenses should either have been ob-
tained, or if such licenses must be obtained post-
acquisition, then the license application(s) should be fi-
nalized so that they can be filed immediately after the
closing.

Many post-closing disagreements stem from earn-
outs or other post-closing compensation or purchase
price adjustments. A clear, concise and open process
for accounting and measuring company performance
should be established during negotiations. This is so
that both parties avoid any surprises or do not believe
that one side is hiding information from the other. If the
amount is large enough, it may also help to have an in-
dependent third party or CPA firm determine what the
earned amounts are under the pertinent agreement.

Cross-border transactions may also face export-
import compliance. If a newly-created entity was cre-
ated to purchase the U.S. entity, and such entity will be
importing, the new entity may need a customs bond.
This is not always required if the U.S. entity survives, if
it is keeping an old name and if it continues to operate
as such. The same scenario may occur if the entity is ex-
porting goods that require licenses from the Treasury
Department, the State Department or the Department
of Commerce. These licenses generally pertain to ex-
porting items to certain countries that may be under
sanctions from the U.S., or the EU As stated previously,
due care must always be taken when dealing in goods
that are controlled items or technology.

Culture, although not a legal issue, matters when it
comes to the success of a cross-border transaction, and
more often than not, it can be the “coup de grâce” to a
transaction – the role it plays in building and maintain-
ing good relations between the parties should never be
marginalized. Europe and the U.S. have very different
corporate cultures and management styles. Europeans,
in particular the Germans, approach the decision mak-
ing process at a corporation in a very methodical fash-
ion, whereas the Americans strongly encourage and ask
for creativity in the decision-making process. The U.S.
corporate culture is one where efficiency, empower-
ment of the employees and equal rights among all staff
are highly valued – not so with the Europeans, espe-
cially the Germans and the Italians, where the culture is
based more on authority, bureaucracy and a centralized
decision-making system. Another example, typical of
the differences between the two continents is the com-
penstation structure rooted in the corporate cultures.
American managers are known to receive very gener-
nous pay packages and this can turn into quite a clash if
an American manager is transferred to a European
country where a European supervisor sees that their
American counterpart is gaining twice as much as they
are and this may be perceived by the European supervi-
sor, as unjustified.
The organizational model at American and European
companies is deeply entrenched with the history of the
respective continents. For example in the U.S., working
contracts are negotiated individually and therefore, ev-
everyone is responsible for his or her own performance in
salary negotiations. In contrast to the U.S. model, a
greater power distance in European businesses charac-
terizes the European organizational model. European
hierarchies do play an important role in negotiations
and are based on authority. Europeans are generally
less individualistic than Americans and can be more
risk-averse than American management. A consider-
able number of cross-border M&A’s fail because of non-
monetary or perception related considerations. If such
factors are addressed at the outset of a transaction and
relationship, it can be more effectively managed after
the completion of the acquisition.

Conclusion

Although acquiring a business in the U.S. may appear
a daunting endeavor to the first time European investor,
if a strategy is implemented early to deal with the issues
discussed, then the acquisition can be very rewarding
and profitable. It is recommended that European clients
avoid the application of prior investment experiences in
their home countries to their current investments in
America. This includes avoiding any broad assumptions
or applying legal principles that do not exist in the U.S.
system. It is advised that the European client hire com-
petent counsel familiar with the U.S. style of drafting
and negotiation of the acquisition agreement in addi-
tion to capably navigating them through the regulatory
framework and overcoming the cross-cultural chal-
lenges in a transaction. By doing so, EU purchasers can
help maximize the value they see in their U.S. business
acquisitions.