MINTZ

# Acquiring U.S. Businesses: Considerations for European Companies and Private Equity Funds

May 09, 2023 | Advisory | By **Marc D. Mantell**, **Robert G. Kidwell**, **Marina F. Rothberg**

**VIEWPOINT TOPICS**

- Mergers & Acquisitions

**RELATED PRACTICES**

- Mergers & Acquisitions
- Private Equity
- Direct Investing (M&A)
- Growth Equity
- Portfolio Companies
- Investment Funds

**RELATED INDUSTRIES**

## 1. Introduction

Global M&A activity has been growing annually over the last several decades. Although 2023 is off to a sluggish start, forecasts from investment banks suggest that the second half of the year may usher in a resurgence of M&A, including cross-border activity. For European companies and private equity funds seeking to acquire U.S. businesses, there are myriad important issues to be aware of, including key differences between M&A in the U.S. and in Europe, U.S. antitrust regulations, the Committee on Foreign Investment in the United States ("CFIUS") review process and Bureau of Economic Analysis ("BEA") reporting requirements.

## 2. Differences Between U.S. and European M&A

Acquisitions of U.S. businesses are similar in many ways to acquisitions of European businesses. In a competitive auction process, bidders will submit bids through a process managed by the target company's investment bank, often without obtaining exclusivity at all, or at least not until the potential buyer has established the superiority of its bid. In other cases, two courting parties enter into a "letter of intent" or "term sheet" (similar to a head of terms), which can vary widely in form and substance, sometimes including a comprehensive suite of terms and other times specifying little other than purchase price. These letters of intent and term sheets are typically non-binding other than specified provisions related to exclusivity, confidentiality and choice of law.

Representation and warranty insurance ("RWI") is very common in the U.S., particularly among private equity firms. The insurer will typically piggyback on the diligence conducted by the buyer, so the buyer will need to conduct and document sufficient diligence in order to obtain coverage. If the buyer does not use RWI, it can choose whether to do comprehensive diligence or limit its efforts to a "red flag" diligence review.

The choice of the structure of the acquisition is also important. The three primary structures used to purchase U.S. businesses are an asset purchase, a stock purchase and a merger. A merger, which is not available in many European countries, including the U.K., is a statutory process triggered by a vote of the target company's stockholders, which results in the buyer acquiring ownership of the stock of the target without the need to contract directly with the target stockholders. Importantly, a merger does not require unanimous consent by participation of target stockholders, with the requisite voting threshold dependent upon applicable state corporate law and company-specific charter and contractual provisions in effect with the target's investors. Each structure has advantages and potential risks related to allocation of liabilities, post-closing remedies, timetable, third-party consents and tax efficiency.

There are many other important differences between acquisitions of U.S. businesses and businesses in Europe, including the following:

- ***The Locked Box vs. Purchase Price Adjustment***: The use of a locked-box mechanism is common in Europe to help price transactions. Under a typical locked-box structure, the purchase price would be determined by reference to a specified, pre-signing balance sheet date, after which the economic risk of the business passes to the buyer. This mechanic is usually accompanied by a prohibition on the target leaking value to its owners after that date and an indemnity for leakage (other than permitted leakage) in favor of the buyer. In the U.S., locked-box mechanisms are rare, though they are increasing in popularity. Most U.S. transactions include a purchase price adjustment mechanism, whereby the purchase price is based on an agreed-upon target for working capital, cash, debt and transaction expenses. The working capital target is often set based on a historical average, though the target may be subject to negotiation to exclude certain items or take into account the growth of the business. In a cash-free, debt-free transaction, the agreed-upon target for cash, debt and transaction expenses would be zero. In addition to any adjustments taken into account at closing based on estimated numbers, the buyer conducts a review following the closing to determine the actual working capital, cash, debt and transaction expenses as of the closing, which may result in a post-closing adjustment to the purchase price. U.S. purchase price adjustment mechanisms result in frequent post-closing adjustments and are often accompanied by a dedicated escrow for the buyer to access in the event of a deficiency. A buyer should consider its approach to this important economic issue early in the process when negotiating a letter of intent or term sheet or making a bid in a competitive process.

- ***Employee Matters***: Employment relationships are governed and regulated differently in the U.S. than in Europe, which can have a significant effect on diligence, timing considerations and documentation required to consummate a transaction. Many of the risks you would hope to uncover in diligence are similar, such as misclassification of employees as independent contractors, discriminatory practices or failure to comply with wage and hour requirements. In the U.S., employees do not generally have the right to continued employment. Employees are presumed to be “at-will,” and either party can terminate the employment relationship with or without cause (absent a contract to the contrary). Written employment contracts are not required under federal or state law and are rare for rank-and-file employees. Labor unions exist in the U.S., but their prevalence varies greatly by industry and geography. If employees are represented by a labor union, then there are additional contractual and regulatory requirements that apply. In many European jurisdictions, such as France, works councils require employee consultation in connection with a sale of a company. These works councils do not exist in the U.S., though labor unions can sometimes serve a similar function.
- ***Disclosure; Buyer’s Knowledge***: In the U.K., it is common to have the entire virtual data room serve as disclosure against the target company’s warranties. In the U.S., it is customary for only those disclosures specifically made in a schedule to the acquisition agreement to be deemed disclosed against the representations and warranties. The U.S. approach is generally viewed as more favorable to buyers. This is especially true if there is a “pro-sandbagging” provision in the acquisition agreement that would permit the buyer to bring a claim even if the buyer was aware of the breach prior to entering into the agreement. In some jurisdictions, merely the absence of an “anti-sandbagging” provision has the same effect. Buyers in the U.S. may negotiate for “pro-sandbagging” language. In the U.K., generally, a buyer cannot bring a claim in such a situation (and will typically request a specific indemnity if the buyer wishes to have a remedy available following the closing).

## 3. U.S. Antitrust Regulations

Businesses contemplating an acquisition of a U.S. target should be aware of the U.S. federal antitrust (competition) laws: The Sherman Act,**[1]** the Clayton Act**[2]** and the Federal Trade Commission Act.**[3]** The U.S. Federal Trade Commission (“FTC”) and the Antitrust Division of the U.S. Department of Justice (“DOJ”) enforce federal antitrust laws. State attorneys general may also bring actions under the federal antitrust laws and their own state antitrust laws. Additionally, private parties may sometimes file suits under the federal antitrust laws.

Mergers are analyzed under Section 7 of the Clayton Act, which prohibits mergers and acquisitions “where in any line of commerce or in any activity affecting commerce… the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.” The primary tool for investigating proposed mergers in the U.S. is the HSR Act,**[4]** which gives the U.S. federal antitrust agencies authority to review proposed transactions. The HSR Act imposes a mandatory reporting requirement for transactions that meet applicable jurisdictional thresholds (and no exemptions apply), and it imposes a suspensory waiting period (typically 30 days), during which time the transaction may not close. For transactions that raise competitive concerns, the antitrust agency may issue a “Second Request” for additional information. A Second Request requires the parties to submit significant additional information and data to the agency, and extends the waiting period until after both parties have substantially complied with the request for additional information. The process of achieving substantial compliance can be time-consuming and costly for the parties. The agencies may seek to block transactions that they determine violate Section 7 of the Clayton Act, Section 5 of the FTC Act, or both. It is also important to note that transactions that are not reportable under the HSR Act (because they do not trigger the HSR filing thresholds) may also be challenged under U.S. antitrust laws.

The U.S. antitrust laws also govern the sharing of confidential, competitively sensitive information between competitors during the diligence and pre-close integration planning periods. In general, while the antitrust authorities recognize the legitimate need for these activities, the exchange of highly sensitive information (such as pricing, strategic plans and employee compensation) should be done with the guidance of antitrust counsel.

## 4. CFIUS Review

Foreign entities contemplating the acquisition of a U.S. business should also be aware that certain transactions require a mandatory filing to the Committee on Foreign Investment in the United States, the federal committee tasked with reviewing the potential national security implications of acquisitions of U.S. businesses by foreign persons. Transactions that are not subject to mandatory filing may also be voluntarily notified to CFIUS (see more on this below). For CFIUS purposes, the foreign status of an entity depends on the nationalities of the individuals with control over the entity; factors such as principal place of business or location of incorporation are not dispositive.

CFIUS reviews deals in one of two ways: either the parties to a transaction notify them of the deal and they review it, or CFIUS discovers the deal on its own and initiates an investigation unilaterally. The review process typically takes a few months, at the end of which CFIUS may either clear the transaction, recommend that the president block the transaction (if the parties notified CFIUS of the transaction pre-closing) or order it unwound (if the investigation occurs post-closing), or require mitigation of perceived risks to national security.

There are two types of transactions for which parties may be required to submit a mandatory notification to CFIUS:

1. Acquisitions where a foreign purchaser acquires a U.S. business that produces, designs, tests, manufactures, fabricates or develops a “Critical Technology” as defined in the CFIUS regulations.
2. Acquisitions where a foreign purchaser whose activities are primarily directed, controlled or coordinated by a general partner, managing member or equivalent, in which a foreign government holds 49 percent or more interest, acquires an interest in either a U.S. business involved in “Critical Infrastructure” or a U.S. business that collects “Sensitive Personal Data” of U.S. citizens, both terms as defined in the CFIUS regulations.

Foreign entities seeking to acquire or invest in a U.S. company should always consult with CFIUS counsel at the outset of the transaction to confirm whether a mandatory notification is required. Notably, there are exemptions in the CFIUS regulations that may eliminate an otherwise mandatory filing obligation. Failure to make a mandatory filing may result in a civil penalty not to exceed $250,000 or the value of the transaction, whichever is greater, and the potential unwinding of any closed transaction.

For most other acquisitions of a U.S. business by a foreign purchaser, parties are not required to notify CFIUS of their transaction, although parties may make a voluntary filing in the form of either a full notice or a short-form declaration notifying CFIUS of the transaction. The benefit of making a voluntary filing is to receive “safe harbor” for the transaction, which can protect the parties from later review (and potential unwinding or mitigation) by CFIUS.

The decision to make a voluntary filing may be particularly prudent in circumstances where the transaction does not trigger the mandatory filing requirement but may generate additional scrutiny from CFIUS, whether due to the identity of the foreign purchaser or the activities of the U.S. business. For example, transactions that involve sensitive high-tech products or real estate near U.S. military installations may warrant a voluntary filing. Foreign entities should consult with their CFIUS counsel to determine the potential benefits relative to the time and cost of making a voluntary filing.

## 5. BEA Reporting Obligations

The Bureau of Economic Analysis, an agency operating under the Department of Commerce, requires certain filings from all U.S. businesses in which a foreign entity owns, directly or indirectly, 10% or more of the voting securities. Foreign entities seeking to acquire U.S. businesses should be aware that acquisitions may trigger BEA reporting requirements. In addition, reporting is also required when a foreign entity establishes a new legal entity in the U.S. or expands existing operations. In each of these cases, filing is required when the cost of establishment or expansion is over $3 million and the foreign entity owns at least 10% of the voting interest of that established or expanded business.

The BEA conducts other surveys on foreign investment in the U.S., including the quarterly and annual surveys, which need only be filed by those contacted by the BEA, and the Benchmark Survey on Foreign Direct Investment in the U.S., which must be completed every five years by U.S. businesses with a foreign parent that meets the 10% voting interest ownership threshold. These reports are kept confidential and are solely used to produce economic data. The BEA is currently gathering responses to the foreign direct investment Benchmark Survey for the fiscal year ending in 2022, responses to which are due by May 31, 2023 for reports submitted by mail or fax and June 30, 2023 for reports submitted through **eFile**. For more information on the Benchmark Survey of Foreign Direct Investment in the U.S. for fiscal year 2022, please see the linked Mintz **client advisory**.

## 6. Conclusion

Although there are many similarities between M&A in the U.S. and in Europe, European entities that intend to acquire U.S. businesses should be aware of key differences that will impact the process, timing and terms of the transaction. Certain common mechanisms in Europe are rare in the U.S., such as the locked box as a tool to price transactions, widespread use of employment contracts and virtual data rooms serving as full disclosure. Further, U.S. federal law may impose additional burdens on a transaction, and parties to a cross-border deal must be aware of antitrust, CFIUS and BEA requirements.

In sum, European entities seeking to transact in the U.S. may rightfully have shared expectations with U.S. parties about the deal process. It is important, however, to connect with domestic legal counsel to ensure that certain particularities of the U.S. M&A landscape, including assumptions about the deal process itself and federal regulatory requirements, do not escape notice.

### Endnotes

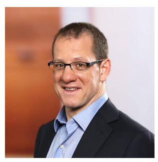
**1** 5 U.S.C. § 1 prohibits "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce." 15 U.S.C. § 2 prohibits monopolization and attempts to monopolize.

**2** 15 U.S.C. § 18 addresses specific practices that the Sherman Act does not clearly prohibit, such as anticompetitive mergers, interlocking directorates and discriminatory pricing (through the Robinson-Patman Act).

**3** 15 U.S.C. § 45 prohibits unfair methods of competition and unfair or deceptive acts or practices.

**4** The Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, (the "HSR Act"), requires parties intending to merge or make acquisitions to notify the FTC and the DOJ before consummating the proposed transaction. Following notification, the parties must wait a specified period of time (usually 30 days) while the agencies review the transaction for any potential antitrust concerns. (15 U.S.C. § 18).

## Authors

**Marc D. Mantell**, Member / Co-Chair, Mergers & Acquisitions Practice

Marc D. Mantell handles corporate and securities law matters at Mintz, primarily for technology clients. He represents companies, investors, underwriters, and other parties in mergers and acquisitions, securities offerings, debt financings, and other transactions.

**Robert G. Kidwell**, Member

Robert G. Kidwell is a Mintz attorney who counsels clients on business strategies, regulatory matters, policymaking and lobbying, compliance issues, privacy, and litigation. He defends clients in class action and competitor litigation, and guides transactions through merger reviews.

**Marina F. Rothberg**, Associate

Marina F. Rothberg is an Associate at Mintz who focuses her practice on corporate and securities law, mergers and acquisitions, and general corporate matters. She counsels public and private companies in a variety of industries, such as life sciences and technology.