Cross-Border Carve-Out Transactions: Conditions & Staggered Closings

This article is Part 3 in a series of 3

By Mark Davies, Partner, and Sawyer Duncan, Associate, of King & Spalding LLP

We have previously examined several key considerations in the context of planning and executing a cross-border carve-out transaction. In our final article in this series, we will focus on various concepts that impact parties' abilities to bring a complex carve-out transaction to a successful, timely closing. A confluence of factors, including the conditionality of the acquisition agreement, the possibility of intervening events and the receipt of required regulatory approvals, drive the timing of a closing.

When many jurisdictions are involved in a carve-out deal, many dealmakers find that certain parts of the target business are prepared for closing on different timetables than other parts of the business. This article will close by discussing deferred closings and related points to keep in mind when deciding whether a deferred closing is appropriate.

Applying Appropriate Conditionality to Closing

Drafting an effective acquisition agreement for a cross-border carve-out transaction requires careful attention to the conditions precedent to each party's obligation to close the transactions contemplated thereby. As in any M&A situation, sellers ordinarily place primary emphasis on receiving a maximal amount of the purchase price as quickly as possible, and they may therefore oppose inordinate closing conditionality in the acquisition agreement.

Buyers, on the other hand, generally want to ensure that care is taken during the separation and pre-closing organization process such that the whole target business is delivered in negotiated form on the closing date. In some instances, delaying the closing for as long as it takes to receive requisite regulatory approvals (or obtain third party consents) can be tolerated.

In other instances, however, a delay in closing of any duration subjects the consummation of the transaction to incremental uncertainties—including by, for example, giving an interloper more time to present a topping bid, by adverse movement in the credit markets that impacts the bankability of the deal, or an increase in the likelihood of a material adverse effect. Further, a lengthy interim period could distract the target management's focus on running the business.

The sooner a deal can be fully completed, the sooner the pro forma combined company can realize valuable synergies and become accretive to the acquirer's bottom line. As in any M&A deal, completion cannot occur until all closing conditions precedent are satisfied or waived—and determining the nature and extent of those conditions is usually the responsibility of counsel.

For buyers in carve-out deals where a pre-closing reorganization is undertaken, it is advisable to install a closing condition or required closing delivery whereby the seller must deliver conclusive evidence of completion of pre-closing reorganizational documents and any attendant ancillary agreements. But other tricky conditionality problems, many of which require a bespoke, factspecific solution, have emerged in previous deals.

Jurisdiction-specific closing conditions, such as works council approval or union-related filings or approvals, can be supplied by experienced local counsel. Confusion can arise as to approvals and actions that are critical for the operation of the target business in one jurisdiction, but not in others. Many times, conditions relating to regulatory approvals will be a contentious point among sophisticated parties:

- Should affirmative receipt of all required regulatory approvals be required as an express closing condition?
- Or should a regulatory closing condition merely require the absence of injunctions or orders restraining or enjoining the closing?
- In any event, how should the parties determine which regulatory approvals they may elect to "close over"? Does a jurisdiction-specific threshold for fulfillment of the regulatory approval condition make sense? Or should regulatory approval be required for jurisdictions in which the target derives a certain percentage of net sales?

- What if an unobtained regulatory approval is statutorily required in a remote, immaterial jurisdiction that is unable to grant it? Should the failure to obtain that kind of *de minimis* approval hamstring the larger closing if other material approvals have already been obtained?

Other transactional conditionality questions can arise as well:

- Should the target's closing condition regarding accuracy of representations and warranties be "brought down" to the same standard for all jurisdictions? What if there are material known diligence issues in only one jurisdiction? Would such an issue belong on the disclosure schedules (where it would typically be deemed an exception to the reps and warranties, and thus outside the confines of indemnification?) Or should it be subject to specific indemnification?
- Are there other parallel strategic transactions currently pending or proposed to be undertaken by either party while your cross-border carve-out is pending (such as an additional carve-out, acquisition, or refinancing)?
- How should the timing and execution of simultaneous strategic transactions be choreographed so as to optimize deal certainty for your transaction?
- How will the closing conditions in such parallel transactions, if any, interact with your deal?

Clearly, these permutations of considerations are highly fact-intensive, often depending on many factors outside of your and your client's control. Counsel should carefully think through the specifics of each transaction and not merely rely on precedents when applying and negotiating conditionality to a cross-border carve-out acquisition agreement.

A smooth closing depends on a contractual conditionality construct that is appropriate in relation to the materiality of the foreign assets and jurisdictions involved. Where a conditionality construct is not carefully tailored to the deal at hand, deal certainty is jeopardized.

Staggered Closings

As we have discussed, cross-border carve-out deal entails both separating the target business from its parent (whether via through asset transfer transactions or some other pre-closing restructuring) and doing so in a manner that complies with the requirements of each jurisdiction in which target assets or subsidiaries are located.

In a deal involving a global, multinational target business located across many jurisdictions, it may be difficult or impractical for all of these transactions to be completed (or recorded, evidenced, filed or funded, as applicable) on exactly the same date.

While many portions of the target business may be otherwise prepared for purchase and sale at one moment in time, other portions of the target business may lack regulatory approval or third-party consent to be validly transferred in a manner that strictly adheres to the terms of a welldrafted acquisition agreement.

Can transactions that span vastly different time zones be legally deemed completed on the same business day? Must the parties delay the closing indefinitely (and encounter the risks described above) while substantial parts of the transaction are otherwise ready to be completed?

Many times, parties will decide to stagger the completion of a complex deal into logically sorted mini-closings, organized by jurisdiction or by key asset for example. Most often, the parties will expressly contemplate and provide for adequate optionality and procedure for a staggered closing at the beginning of a transaction.

Where jurisdiction-specific approvals, for example, are expected to lag other aspects of the completion of the larger transaction, a staggered closing can be useful—if it is thoughtfully implemented. The benefits of a staggered closing include lesser likelihood that a topping bidder intercedes and allows counsel and advisors to hone in on the execution of the unfinished parts of the deal.

A staggered closing can also elucidate some of the confusion that arises when determining a conditionality construct for the overarching deal, where various closing conditions can be "silo-ed" in a logical order that corresponds to each staggered closing. Representation and warranty veracity and "material adverse effect" bring-down conditions can be neatly bifurcated, by jurisdiction, by subsidiary or otherwise. In these ways and others, a staggered closing can, under certain circumstances, present clarity during the often-murky exercise of conceptualizing when certain pieces of the target business pass to the acquirer.

A staggered closing, however, is not without considerable risk to acquirors—especially when it is not initially contemplated at the outset of a transaction process. In many cases, parties can do their best to estimate the likelihood of receiving regulatory approvals or fulfilling closing conditions by a date certain, but at the end of the day, an estimate is just that.

Any delay in closing can be value-destructive where the deal thesis depends on the achievement of meaningful synergies. If an acquisition agreement has been drafted only with a singular closing in mind, a subsequent decision to implement a staggered closing can become a tall order if not carefully planned.

Because a staggered closing entails that the delivery by the seller of certain pieces of the target's business would be deferred, these situations present heightened risk to buyers that they may not ever actually receive all of the target business that they believed they were purchasing at the time of signing.

Further, even if all of the component parts of the target business do eventually close in a successfully staggered manner, multiple closings can reduce an acquiror's leverage and relieve the seller of pressure to deliver the target business in full, negotiated form on the agreed-upon timetable. Buy-side counsel thus should pay close attention to the following considerations:

- How might the purchase price be affected in the event buyer must accept lesser ownership at an initial closing than anticipated at signing? Should the acquisition consideration be disbursed to the seller in correspondingly staggered payments?
- Would financing sources still be willing to lend the full purchase price, on the same terms and conditions, against acquiror's ownership, at the time of an initial closing, of only a portion of the target business?
- How would a networking capital adjustment mechanism be applied across staggered closings? Ideally, an adjustment for each jurisdiction would take place in accordance with the chronology of each closing—otherwise, if there is one single net working capital true-up at an initial closing, the acquirer risks paying for a working capital profile that it may not actually receive.
- How should the parties address the existence of other closing risks during the pendency of the deferred closing? Should the deferred closing event maintain the same conditionality as the non-deferred closing events?
- How should interim operating covenants in respect of the deferred assets or operations be shaped to accommodate a longer delta between signing and closing? To what extent can an acquirer "tighten" such covenants while not running afoul of applicable antitrust or competition law regimes?
- If a required closing condition cannot ultimately be fulfilled or waived in any delayed jurisdiction, can the acquirer nevertheless operate the business in the same manner it was previously operated? What should happen if not?
- How would the economics of the target business be allocated while a deferred closing remains pending? Must the acquirer take the aggregate profit and loss statement for the entire target business even if it fails to operate significant portions of it?
- How would investors and other stakeholders react? Would the announcement of a decision to stagger the closing affect the commercial contract consent process with vendors and customers?

Takeaways

- When advising on large-scale cross-border carve-outs, apply a conditionality construct that is appropriate in relation to the materiality of the foreign assets and jurisdictions involved.
- Deferred closings can represent a useful compromise when there are components of a global target business that become ready for closing on disparate timetables. However, a staggered closing can present additional complexities that must be carefully thought through.