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Cross-Border Carve-Out Transactions

This article is Part 1 of a series of 3

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

Globalization and technology continue to drive companies of all sizes to discover and unlock value in ways previously considered unconventional or impracticable. One notable trend witnessed in today's M&A marketplace has been the significant uptick in international business separation "carve-out" transactions.

Multi-jurisdictional elements invariably complicate these transactions, but market participants are nonetheless increasingly choosing to brave the potential complexities of these deals as they reach deeper into more remote and tangled baskets of assets in search of enhanced value. While there is much literature on the topics relating to sound carve-out deal execution in a single-jurisdiction vacuum, this series of articles addresses several important issues and considerations that are relevant to an international carveout deal.

This first installment will review current market trends for cross-border carve-out deals, and it will also highlight the importance of both understanding the scope of each deal and assembling the key team members necessary for a smooth closing of the transaction.

State of the Market for Cross-Border Carve-Outs

Let us begin with a few observations on the current state of play in this space in both the large cap and micro-cap segments of the market. At the top of the market, large multinational strategics, as buyers, are looking to expand their offerings, market share and reach.

As rapidly scaling major technology companies such as Amazon loom over unwary strategic companies in unrelated verticals, some buyers are playing both offense and defense with cross-border carve-out deals. And as sellers, many times under pressure from activists who are urging focus on core competencies, large multinational strategic companies are looking to shed "non-core" assets.

Meanwhile, global private equity funds, with very large amounts of dry powder, are beginning to chase new carved-out global platforms in an ecosystem where traditional standalone acquisition targets continue to fetch some of the highest multiples on record. We have also been seeing private equity funds bid with fervor on business divisions for which they do not have a current portfolio framework at the time of an auction process, opting instead to source the organizational infrastructure and management team for the to-be-acquired business during the interim period between signing and closing.

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And at the bottom of the market, even simple businesses with best-in-class offerings are more commonly utilizing international features (most commonly sales or distribution presence) to boost top-line revenue, many times with non-U.S. facilities, office locations or staff. Thus, even for micro-cap sponsors and other less cash-rich bidders focused on "regional" assets, it is more common to encounter a situation with a crossborder element today than it was even just five years ago.

Against this backdrop, it is important for practitioners in all segments of the M&A market to be fluent—or at least conversant—in these issues, as their prevalence will only increase as global deal-making accelerates and attractive standalone targets become more scarce. Effectively executing a cross-border transaction of any size is complex for many reasons, and this article does not purport to describe all of the issues that deserve due care when negotiating and closing a cross-border carve-out transaction.

M&A lawyers should also review the ample materials available regarding garden variety carve-out deal points in tandem with this article—such as regulatory concerns, carve-out financial statement preparation, treatment of commingled assets and shared contracts, the "your watch, our watch" indemnity construct (and alternatives), tax-free spin structuring matters, operational integration issues, and others.

Understanding the Deal Scope

Cross-border carve-outs are especially challenging because they require that two onerous work streams be completed in parallel—a separation of the target business from its parent and ensuring that such separation complies with the laws of each country involved. When a client calls with a mandate for a new cross-border carve-out deal, the appropriate next move depends entirely on the scope and scale of the proposed transaction—the identities of the parties, the jurisdictions involved, the deal value, and the thesis underlying why *this* transaction (and not another strategic alternative) is on the table.

When the deal at hand is one involving two multinational public companies operating in the same or similar sectors, it's wise to first discuss the deal with your tax partner and antitrust partner, after clearing conflicts. Whether a tax-free transaction structure is accessible and whether your deal will pass regulatory muster are threshold questions that will inform your next steps.

Other key questions to ask and research include:

- How "material" to the target business is each jurisdiction involved?
- How much revenue is derived from each country in which target assets are located?
- What types of assets are housed there?
- What is the employee headcount in each country involved?

A twoperson independent contractor sales team with a vanilla office lease and some computers in the Netherlands will entail a much different conceptual approach than would the presence of over a dozen manufacturing plants used in disparate product lines that are distributed on all continents.

Another relevant question for client and counsel to consider is how much time remains on the proverbial shot clock. The delta anticipated between signing and closing circumscribes the scope of work and study that can be undertaken by you and your client.

For example, if it is suspected that your crossborder carve-out deal will receive a HartScott-Rodino Act "second request", then you have temporal flexibility to conduct more thorough diligence, arrange financing, negotiate certain key ancillaries (such as pre-closing reorganizational documents to consolidate the target business or transition services agreements and reverse transition services agreements) and mutually establish a comprehensive closing process during the interim period between signing and closing.

Parties may not enjoy as much flexibility, however, in the context of an international competitive multi-bidder private equity auction for a small-cap target that is financed with cash on hand or that otherwise may contemplate a simultaneous sign-and-close feature. Cross-border carveout deals populate each point along this continuum; accordingly, no two deal processes will be identical.

Assembling & Guiding Cross-Border Deal Teams

It generally takes a substantial team to negotiate and close a cross-border carve-out deal. Your client's board of directors will need to be equipped with all of the requisite information to fulfill its duties while at the same time avoiding becoming overwhelmed by a tidal wave of process points.

It is not possible for managing deal counsel for both buyer and seller to be masters of the universe on all issues, at all times and in all places. Creating a roster of team players and outside advisors will be critical to maintaining sanity on the path to closing. Where practicable, engage external advisors that have global reach and expertise, such as "Big Four" accounting firms for financial due diligence.

If employee benefits or labor advisors are necessary, make sure you select an advisor that has deep experience in the labor and benefits laws of the jurisdictions involved. As in any M&A transaction, thoroughly vet your client's financial advisor for conflicts of interest, and consider whether it makes sense to engage a second advisor to protect the propriety of your deal process and the reputation of your client's board.

Solicit local counsel recommendations and be judicious in counsel selection if your client defers to your decision. The scope of your deal will necessitate varying levels of engagement with lawyers around the world, who can either make the process demonstrably easier or demonstrably worse. Effective and proactive local counsel will free up your valuable time to meaningfully interact with your client, its board, and opposing deal counsel, so that you and your colleagues can remain focused on the negotiations and the key issues.

It has been our experience that busy clients prefer inbound contact to come from one centralized point of command, as opposed to piecemeal from each outside law firm from Algeria to Zimbabwe. "Over-visibility" of local counsel, especially with respect to small-dollar items, can distract your client's team from critical deal points and foster a "too many cooks in the kitchen" sentiment.

For the big deals where international assets and operations are material and numerous, you may consider engaging a global firm as "project management" counsel—in charge of the various distributions of timely critical information, commissioning jurisdiction-specific due diligence memos or disclosure schedule riders, shepherding and consolidating jurisdiction-specific comments to the acquisition agreement, scheduling telephone conference calls across time zones and more.

For smaller cross-border deals, solicit recommendations from inside and outside of your firm and ask for references from prospective local counsel on a case-by-case basis where appropriate. Where a single local firm can handle multiple jurisdictions in a given geography without compromising quality, consolidate your local counsel and encourage appropriate regularly-scheduled collaboration between teams.

Consider fee caps for each country, and, where you have your client's consent, allow local counsel to submit invoices to your firm only and roll those smaller balances up into your firm's ultimate invoice for ease of payment.

In all cases, clearly explain the task to be performed by each advisor and negotiate a clear budget in each jurisdiction that is tailored to the corresponding scope of work. Ask your client whether itemization of fees by jurisdiction would be helpful. Make the effort necessary to prime local counsel to deliver actionable and helpful work product by giving them examples and using clear instructions.

Consider preparing an omnibus transaction background memorandum (containing info on the parties, the key transaction documents in existence, annual reports and other material securities filings, target profiles, acquirer financing papers, banker materials, and other commonly referenced documents) that can be readily shared with each local advisor. You may consider designating an appropriately junior team member to the sole function of process management, cross-team communication, scheduling and logistics of execution.

Finally, for team leaders on these matters, build trust within your internal and external teams to execute each smaller assignment with quality, and aim to spend most of your time with the client's general counsel, Board and management, focusing on the larger architecture of the overall transaction.

Takeaways

- For several reasons, we are witnessing a notable proliferation of cross-border carve-outs. These types of transactions are likely to increase in frequency going forward, and practitioners who are not prepared for the intricacies of these deals will be severely disadvantaged should their client pursue a cross-border carve-out opportunity.
- "Failing to prepare is preparing to fail." The process for swiftly and effectively executing a cross-border carve-out transaction will vary dramatically based on the scope of the deal. Taking the time to understand the scope of the deal at the front end lessens the likelihood of unanticipated consequences and sub-optimal outcomes.
- An effective deal team on a cross-border carve-out deal must be selectively commissioned and thoughtfully primed to make the process simple for the client and to consistently deliver reliable client service.

<u>Cross-Border Carve-Out Transactions: Due Diligence and Purchase & Sale</u>

This article is Part 2 of a series of 3

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

In our first article in this series, we provided several initial, planning stage-level considerations for companies and counsel evaluating a cross-border carve-out M&A transaction. As deal teams advance from the planning stage toward transaction execution and implementation, additional care must be taken to successfully effectuate this type of complex transaction.

Our second installment will discuss important concepts in crossborder carve-out deal process related to transaction preparation and pre-closing matters, due diligence, and the mechanics of the purchase and sale of the target business.

<u>Identifying and Defining the Target Business</u>

As in any single-jurisdiction carve-out deal, it remains critical for the parties to identify and clearly define the target business (which may involve defining that which is *not* part of the target business) in a manner that is clearly expressed and consistently applied throughout all of the transaction documents. This may sound simple but often can be difficult in a cross-border context; it is the product of many conversations between the parties and a precise, thoughtful due diligence effort.

Failure to reach a clear, thematic understanding on which parts of the business should flow to the acquiror and which should remain with the seller can greatly increase transaction costs and instances of frustration, as well as the likelihood of a dispute among the parties. In an age where the rapidity of transaction execution has seemingly become paramount for sophisticated parties, acquirors and sellers in cross-border carve-out situations should equally prioritize sound process. In that context, the value of meaningful pre-deal conversations and discussions across multiple layers of each party's organization cannot be overstated in a cross-border transaction involving many jurisdictions.

Beyond conceptual agreement upon the business that is the subject of the transaction, it is also important to carefully and properly describe the business in the transaction documents. A thorough and neatly-tailored defined term for the "<u>Business</u>" will have important ramifications throughout the primary transaction agreement and ancillary documents.

Carve-out transaction agreements reference the transfers of assets, liabilities, contracts, real property, employees, and intellectual property that relates to the target's Business. The definition of the Business should then, from an acquiror's perspective, be appropriately broad so as to ensure that the acquiror indeed receives the entire suite of assets and equity that it expects. From a seller's point of view, an overbroad definition of the Business could imply that the seller must carve out a larger amount of its operations and deliver more of its assets than expected.

Furthermore, non-competition covenants in cross-border carve-out agreements, which are becoming increasingly common, will almost always key off of the definition of the Business for purposes of determining the universe of restricted activities during the non-competition period. Therefore, even where the definition of the Business is not directly used to specifically describe the assets and consideration to be delivered to an acquiror at closing (as may be the case when a "Transferred Assets" and "Transferred Equity" definitional construct is used, or where target assets are set forth on an appended schedule), a seller should nevertheless be attuned to the risk of an overbroad "Business" definition that has restrictive covenant implications.

It is also common for the definition of the Business to liberally flow through the target's representations and warranties, and an unwary seller could thus become indemnifiably responsible for inaccuracies relating to retained parts of its operations that are not actually being transferred, but that may nonetheless be encapsulated by an overlooked and overbroad Business definition.

Further to the point of constructing these definitions, in the context of multinational target companies with international presences, it is important for acquirors to make sure to include both the appropriate verbs that describe the operations of the Business, as well as the appropriate nouns that capture all of the products and offerings of the Business. To illustrate, consider the following two drafting examples and the potential ripple effects through a hypothetical transaction created by each:

> "Business" means the business of Seller as conducted as of the date hereof, including the sale of products.
>
> "Business" means the global consumer products business and operations of Seller as conducted as of the date hereof and as of the Closing Date, including the design, manufacture, marketing, distribution and sale of products that include household cleaning solutions, adhesive products, batteries, lighting products, light bulbs and other products that may be delivered, transported, installed or otherwise placed in the stream of commerce by Seller or any of its Subsidiaries, or any of their respective predecessors in interest. For the avoidance of doubt, the Business shall not be deemed to include any "Retained Businesses" of Seller.

Asset Separation

In many cases, a global business unit that is the target of a cross-border carve-out transaction is not neatly packaged in separate subsidiaries, unconnected offices, or independent information systems that correspond to the division of the seller that is up for sale. Assets comprising a global business unit that is to be carved out from a parent and sold are frequently highly commingled, co-owned, co-located and possibly co-encumbered.

Contracts and equipment, especially for overhead or other shared services, may be shared between the target business and another retained business. Sometimes, to-be-acquired assets are titled in the name of a seller entity that is not part of the transaction and whose stock would not otherwise be transferred to an acquiror-owned entity at closing. Physical space can be shared by employees that perform work for a retained business of the seller.

In such cases, shared assets should be migrated, by conveyance or otherwise, to a seller entity that is to be acquired, since the failure to do so would deprive the acquiror of a portion of the business for which the acquiror is paying the purchase price. There can nonetheless be substantial breakage costs and lead time involved in this decoupling of the component parts that sum to comprise the target business.

Preferred methods for detaching these assets from the seller's ownership and preparing them for acquisition and integration by the acquiror again depend on the length of the anticipated timing between signing and closing. Where asset commingling is heavy and not neatly divided among separate subsidiaries, a long interim period can provide an opportunity to complete a comprehensive series of detailed pre-closing reorganization transactions. A pre-closing reorganization is typically comprised of equity purchase transactions (to transfer ownership of seller's subsidiaries that hold assets of the target business to acquiror) or asset purchase transactions (together with any related consents or approvals) that repackage the commingled target assets into a new or existing transaction subsidiary for purchase by the acquiror.

Sellers should take care to ensure that pre-closing reorganization documentation (i) is precisely drafted to include the appropriate descriptions of transferred assets and liabilities and (ii) does not purport to transfer a universe of assets and liabilities that extends *beyond* those used or held for use in the target business. Preclosing reorganization transactions should be duly authorized by the governing bodies of the subsidiary entities involved, typically by written consent.

In certain cases, asset and liability transfer transactions can create unintended tax consequences—either by creating tax liabilities or by altering tax benefits formerly available to the entities involved. Any tax consequences of a pre-closing reorganization should be not be deemed to constitute an adverse effect on the subsidiary entities involved, and sellers would be wise to include an acknowledgment in the transaction agreement to this effect.

The completion of a pre-closing reorganization also presents several areas to monitor from the acquiror's perspective. Since the seller is responsible for preparing the delivery of the target business to the acquiror during the time which it continues to own that business, acquirors may wish to have some level visibility (*i.e.*, review rights or notice rights), if not control over (*i.e.*, consent rights), the integrity of the seller's preclosing reorganization paperwork.

Acquirors often contend for a fulsome sufficiency of assets representation and warranty in the transaction agreement, sometimes with an extended survival period, and they sometimes insist that satisfactory completion of the pre-closing reorganization to complete the asset separation process should be an express condition precedent to the closing of the larger transaction.

Unique Considerations in Cross-Border Carve-Out Diligence

Once there is thematic understanding between the parties as to which parts of the target business are to be purchased and sold, due diligence efforts with respect to the target business can be meaningfully undertaken. Performing due diligence in the context of a cross-border carve-out transaction can be as much an art as it is a science. In a perfect world, acquirors would have complete and timely access to a target business, its management, its books and records, and facilities. In a cross-border carve-out transaction, full and perfect access is rarely available for a number of reasons, and if not carefully planned, a due diligence investigation of a global business can quickly become chaotic. In our experience, we have observed that the due diligence exercise in a cross-border carve-out deal can be complicated by a number of factors:

- Scope: The amount of diligence and investigation needed to effectuate a cross-border carve-out deal is much more expansive than a garden-variety domestic merger. Since the target business exists across multiple and disparate countries, product markets, regulatory environments, financial reporting regimes and professional and interpersonal cultures, an acquiror and its deal team must accordingly examine the target business through each such lens.

- Geography: Target assets may be scattered across the world. It is impossible for an acquiror to conduct an identical due diligence process at all times and in all places where target assets are housed. Local consultants or advisors may need to be engaged for remote site visits. Management interviews may not be capable of being conducted by the same team due to language differences. Time zone differences may complicate work that references a specific time or date, such as inventory counts.

- Separability: Target assets, such as leases, contracts and licenses, may be utilized by the target business as well as a retained portion of the business that is not part of the transaction. In such instances, analyzing the relevant contract provisions for assignability will require additional effort.

  When assets are "shared", the parties must decide whether to separate the shared asset (such as terminate an existing lease for a shared office in order to establish two office locations—one that stays with the seller and another that goes with the acquiror), or to continue a shared arrangement (such as a sublease in favor of the seller of the existing leased location). When shared assets cannot be permissibly shared, however, such as a key permit or governmental authorization, the acquiror must form a plan for obtaining or replacing the shared asset so that it may operate the business after the closing in the same manner it was operated prior to the closing.

- Access: In U.S. practice, advisors often take for granted the near-immediate availability of business information. Securities exchange filings, state-level annual reports, tax assessor documents and appraisals, Uniform Commercial Code lien search results, PACER litigation filings, registrations and qualifications to do business, good standing certificates and other tools are commonly deployed (many times electronically and at low cost) to understand a target's business and operations at a high-level.

  In other jurisdictions, however, obtaining information about security interests and encumbrances, for example, can take substantially more time to obtain and sometimes require an in-person presence at a municipal office. Some countries may not have a centralized recordkeeping function or data infrastructure with respect to certain types of business information. In these types of situations, the lack of full and timely access to a suite of due diligence information can impair an acquiror's ability to assess holistic transaction risk *ex ante*.

– Regulatory: It is critical to identify jurisdiction-specific approvals from regulatory authorities at the outset of a transaction process. At a high-level, key antitrust approvals and merger control clearances, without which the acquisition does not make sense, should be identified and agreed early in the process. As will be discussed in our final article, applying a sensible closing conditionality will undoubtedly involve the study of all such approvals needed (and the likelihood of timely attainment) in order for the acquiror to operate the target business after the closing.

– Timing: Finally, in today's market, no deal process for a desirable target business is afforded an unlimited "shot clock". The pressure to negotiate and sign a definitive agreement as promptly as possible has only increased over recent years. Strategic interlopers, private equity funds, and activist factions can and do intervene in ways that may be highly disruptive to transaction execution. Therefore, acquirors must get comfortable with the reality that *full* and perfect diligence in the cross-border carve-out context remains a luxury. Determining the appropriate level of investigation that constitutes *due* diligence is paramount when seeking to timely execute on an M&A carve-out opportunity. Below, we offer a conceptual framework for thinking about the appropriate amount of due diligence for your situation.

Determining the Appropriate Level of Diligence

There is a clear, logical relationship between the amount of time that parties are afforded to negotiate and close a cross-border carve-out deal, on the one hand, and several other due diligence-related transaction variables, on the other hand. Where the deal timeline is extremely accelerated, the due diligence exercise will necessarily be truncated in a way that creates ripple effects through the acquisition agreement. With the parties unable to complete a customarily thorough inspection of the target company, a compromise that is based on what's feasible must be reached.

Timing Available for Diligence Investigation:	**Potential Scope of Legal Due Diligence Work Plan:**	**Potential Legal Due Diligence Deliverable:**	**Risk Allocation and Representations and Warranties ("R&Ws"):**	**Extent of Target's Disclosures Against R&Ws:**
Extremely Limited	Reliance solely on public information, audited financial statements and securities filings, disclosure schedules to publicly-filed debt documentation.	Limited to summary recitation of known liabilities of the type required to be disclosed by law or on an audited balance sheet.	Buyer-Preferred: Extremely limited qualifiers and expansive R&Ws. Rationale: Buyer has not been afforded meaningful opportunity to investigate the target, and must therefore allocate risk through fulsome R&Ws. Seller-Preferred: "Material Adverse Effect"; knowledge qualifiers Rationale: Seller has not been afforded meaningful opportunity to perform internal diligence, verify its representations and warranties and fully populate its disclosure schedules.	General, narrative disclosures; limited references to agreements, documents and factual circumstances.
Limited	Due diligence request list Q&A; lien searches; litigation searches; intellectual property searches; entity-level incorporation/registry searches; limited virtual data room population.	Limited to summary recitation of known liabilities and issues expressly identified by target pre-signing.	Potential Compromise: Materiality qualifiers; chronological "look-back" qualifiers.	Disclosure of material items; limited specific disclosures.

Timing Available for Diligence Investigation:	Potential Scope of Legal Due Diligence Work Plan:	Potential Legal Due Diligence Deliverable:	Risk Allocation and Representations and Warranties ("R&Ws"):	Extent of Target's Disclosures Against R&Ws:
Moderate	Management interview teleconferences; supplemental and follow-up due diligence request list Q&A; substantially full virtual data room population.	High-level "red flag" summaries of known material issues and potential unknown liabilities; short-form due diligence reports in key areas.	Potential Compromise: Tailored materiality qualifiers.	Moderate specificity.
Substantial	In-person site visits; stakeholder/customer/ supplier interviews; third-party consultant engagement; facility-specific due diligence; environmental sampling/Phase I reports; etc.; full virtual data room population.	Comprehensive, long-form due diligence reports; third-party studies; etc.	Buyer-Preferred: Extremely limited qualifiers and expansive R&Ws. Rationale: Even where buyer has had sufficient time to fully investigate the target, comprehensive contractual R&Ws are necessary to preserve buyer's access to indemnification. Seller-Preferred: Limited, tailored materiality qualifiers Rationale: Seller may require qualifications to R&Ws in order to reduce its scheduling burden and preserve deal timeline.	Fulsome disclosure; full specificity.

Key Cross-Border Diligence Areas in 2019

Understanding the complications of a proper due diligence investigation, as well as having developed an appropriate work plan for finalizing the due diligence effort, parties must then identify the universe of key diligence issues that could pose risks to closing or create leakage in value after closing. In today's market, we believe the following due diligence areas are of critical importance in cross-border carve-out deal execution.

These highlighted diligence areas are, of course, not exhaustive and should be studied in addition to all of the other customary subject matter areas that may be implicated by each individual situation.

– Tax & Structuring: Understanding the tax implications of an acquisition target with global operations and historical liabilities is a key first step in developing a reliable valuation premise. Tax-advantaged transaction structures previously thought exotic (such as reverse Morris trusts and other Section 355 spin-offs) are becoming more common.

  In addition to developing a tax-efficient transaction structure and separation methodology, there can exist either tax liabilities (transfer taxes, stamp duties, VATs, unresolved contingent tax liabilities or controversies) or assets (net operating losses, incentives, other credits) in the target business that flow through to the acquiror after closing.

– Anti-Corruption, Trade and Sanctions: As FCPA enforcement and anti-bribery scrutiny intensifies, a global business with global customers must be carefully examined, as anti-bribery liability can be inherited by an unwitting acquiror. Does the target do business with "blocked" countries? How does the target ensure reliable compliance with applicable anti-bribery frameworks? In today's political climate with heightened risk of economic sanctions and tariffs ongoing among major markets, parties should think proactively about an appropriate risk allocation should an adverse trade event occur.

– National Security & Data: President Donald Trump has enlivened the focus on regulatory approval of transactions that involve aerospace, defense, infrastructure and technology (including semiconductor technology). Being aware of the likelihood of such review (whether by Committee on Foreign Investment in the United States or otherwise), and implementing a sensible risk allocation tailored to such likelihood is a key task for parties operating in these industries.

Further, the broad reach of the E.U.'s General Data Protection Regulation has already begun to reshape the manner in which parties think about information technology integration and data migration from target to acquiror. This is especially impactful for target businesses whose core operations are large in scale and involve regular collection of customer personal information. We anticipate that regulatory approval of M&A transactions could one day include data aggregation considerations, in addition to traditional antitrust considerations such as market share and economic competition.

– Pension, Labor and Employment Matters: Where deal valuation depends on achievement of synergies, acquirors should be acutely aware of the many potential regulatory impediments to synergy achievement, such as the rights and influence of works councils, labor unions pension trustees and other employee factions. Funding of "underwater" pension liabilities may be required in order to absorb a workforce in European jurisdictions.

  These factions often exhibit considerable elements of bureaucracy, and it can be difficult for parties to achieve these kinds of approvals on an expedited basis. Delivering advance notices and developing a proactive communication strategy can be an effective way to overcome such roadblocks.

Mechanics of Purchase and Sale & Acquisition

At the closing, the target business is delivered to an acquiror by two mechanisms that are described in detail in a cross-border carve-out acquisition agreement: (i) the purchase and sale of target business assets (in an asset purchase fashion) and (ii) the purchase and sale of equity interests (in a stock or equity purchase fashion) of subsidiary entities of the seller where the operations of such entities relate to the target business. The usual considerations follow.

For the asset transfer, assignment and assumption documentation, intellectual property transfer documents, and a bill of sale are the primary ancillary documents involved. For the stock transfer, stock power agreements or transfer of physical stock certificates of the purchased subsidiaries will be involved.

The asset purchase and sale mechanism will bring the usual suite of considerations for counsel to document with respect to third parties. Where third-party consents are required, an analysis should be undertaken to find out which consents are critical, versus merely desirable or preferred. Should attainment of critical consents be a condition to closing?

Target assets that, for whatever reason, cannot be transferred at closing are often referred to as "non-assignable assets". In the case of non-assignable assets, the customary provision regarding further assurances and efforts on the part of the seller to make future conveyances can be helpful, but several intricate variations on the seller's obligation to effectuate future conveyances are creeping into market practice.

For example, are "efforts"-based standards relevant in a post-*Akorn v. Fresenius* world? Should there be a chronological or monetary threshold put in place that would dictate when sellers are not obligated to use such efforts? If sellers cannot ultimately deliver clean title to assets that the acquiror believes it has purchased under the language of the transaction agreement, how do the parties ensure that the acquiror receives the benefit of those assets after the closing?

Where the revenue attributable to non-assignable assets (such as leases for manufacturing facilities or customer contracts) could be material, do sophisticated parties really want to be relegated to reliance on broadly-drafted concepts in a terminable transition services agreement or opaque legalese concepts like "constructive trust"?

Further, part of the post-closing complexity for acquirors is arranging the assets and equity it just bought into its existing corporate body. Purchased assets will need a purchasing entity to take ownership of them, and the transfer process is more straight-forward when an acquiror's asset-purchasing entity is domiciled in the same jurisdiction as the seller's asset-selling entity.

If the acquiror does not have local operating subsidiaries that are primed to absorb these transferred assets and assume any transferred liabilities, the acquiror should use the interim period to establish its own local wholly owned subsidiaries that are prepared to receive those transferred assets at the ultimate closing. While this approach is more effective when time permits, it is also more costly, and it will require a separate workstream and a miniature checklist to track.

Generally, an acquiror will want to ensure that, among other things, all of the assets it is expecting to receive are subject to transfer and continue as part of the target business post-closing. Acquirors should also ensure a mechanism exists for all encumbrances to be removed (such as any under a seller parent's blanket credit agreement). Finally, the acquiror should ensure that all such equity purchases and asset transfer transactions should be effectuated and documented in accordance with local laws.

Any pre-closing reorganization documentation should be kept simple and thematically consistent with the master acquisition agreement. Typically, where permissible under local law, this local transfer documentation utilizes heavy incorporation by reference to the master purchase agreement and is not subject to separate substantive negotiation or conflicting substantive terms. Therefore, it should not be surprising or discomforting for local transfer documentation to assume a substantially abbreviated form.

Although the preparation of this documentation is not conceptually difficult, it can be very time-consuming to implement and finalize. By way of example, we caution that we have seen local asset transfers require voluminous ancillary documentation, requiring use of forms unavailable in English, multiple witness signatures and apostilled oaths, and even mandatory in-person appearances at foreign offices that maintain irregular hours of operation or poor recordkeeping.

Further, some jurisdictions may require that the purchase price (or a portion thereof), denominated in a local currency and sometimes non-nominal in amount, must actually be paid between the parties in exchange for the transferred assets. Examples and considerations in deal execution such as these illustrate the attention to detail required and the value-add of experienced transaction advisors in the context of high-stakes transformative global M&A events.

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.