CONSIDERATIONS FOR U.S. INVESTORS IN EUROPE

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Cross-border M&A and investment continue to become ever-larger features of the global economy. In particular, while U.S. inbound activity levels are diminishing, those of Europe are increasing. For the second year running, Europe has surpassed North America as the largest inbound market for cross-border M&A. There were approximately 2,500 U.S. outbound cross-border deals in 2018, with almost half of those in Europe. The United Kingdon, Germany, France, Spain and Italy rank highest as targets for U.S. companies seeking to invest in Europe. Yet with the rise of inbound European investment has come an increasing air of protectionism across the continent. In the past year, we have seen heightened political and regulatory scrutiny of foreign direct investment by both the E.U. and individual European countries. Meanwhile, Brexit negotiations continue to cause uncertainty – although overseas investors seem keen to look past this, with the U.K. overtaking the United States this year to become the largest M&A market in the world.

Outlined below are several key issues which are likely to arise in the context of an acquisition or strategic investment in Europe by a U.S. company, and which should be carefully considered in advance of any such transaction. As each cross-border deal is unique, the relative significance of the issues discussed below will depend on the specific facts, circumstances and dynamics of each particular situation.

Political and Regulatory Environment. A recent increase in the scrutiny of foreign direct investment at the levels of both the European Union and specific Member States reflects how cross-border dealings in Europe are becoming increasingly politicized. It is therefore more important than ever for U.S. acquirors and investors to undertake a careful analysis of the political and regulatory implications of a transaction at both an E.U. and national level. High profile transactions, particularly those in sensitive or regulated industries such as technology, energy, defense and aerospace are routinely drawing heightened political and media attention. Although the increased scrutiny has been principally directed at Chinese foreign investment, plenty of other nations have also been affected. For instance, 2018 saw a strong negative media and political response in the United Kingdom to the hostile takeover of aerospace and automotive company GKN by Melrose Industries, with Members of Parliament urging the government to block the takeover of what was perceived as a stalwart British company. Meanwhile, in both France and Germany, there has been a push for increased government support for domestic businesses. In February, shortly following the European Commission's rejection of the Siemens-Alston rail merger, France and Germany announced plans to lobby for a review of E.U. antitrust regulations in order to allow the creation of European industrial "champions" better able to compete with U.S. and Chinese multi-nationals. The United Kingdom, France and Germany have all also recently tightened their foreign investment screening processes. New U.K. government proposals to review transactions on national security grounds capture a much wider range of transactions that under most merger control regimes. In Germany, Federal Ministry for Economic Affairs and Energy screens acquisitions of 25% or more of the voting rights of German companies by non-EEA investors. In December 2018, the German foreign investment regime was revised to lower the review threshold to indirect and direct acquisitions of at least 10% of voting rights for German companies operating in the arena of "critical infrastructure" (a widely defined term including energy, healthcare, financial services, insurance, military products and certain areas of media).

In February of this year, the E.U. approved the adoption of a regulation establishing a framework for screening foreign direct investments into the E.U. on the grounds of security or public order. Although the regulation will not apply until some point in 2020, it is worth bearing in mind as it is set impact the timing of any overseas investment which meets the review threshold. The regulation defines foreign investment broadly as an investment which creates or maintains "lasting and direct links" between a third country investor and an undertaking carrying out an economic activity in a Member State. While the regulation stops short of introducing a veto right, it promotes information sharing between Member States, enables the European Commission to issue non-binding opinions and allows other Member States to provide comments. Where a foreign investment is subject to a national review process within one Member State, other Member States will be able to provide comments within 35 days of being notified and the European Commission has a further five days beyond that to issue an opinion. Even if an investment is not subject to a national review, the Commission and other Member States may still provide comments for up to 15 months after completion, although the extent to which the recipient Member State is expected to heed those comments is unclear. Transaction due diligence will need to take into account the broad scope of much of the forthcoming legislation. Any government or regulatory body concerns should be considered thoroughly, particularly as any perceived weakness in being able to clear regulatory hurdles could be used by reluctant targets or competing bidders to frustrate or delay the completion of an acquisition.

M&A Practice. U.S. companies looking to acquire European targets, or significant stakes in them, will need to heed the wealth of differences in takeover regulation and practice between the European Union and the United States, as well as between individual E.U. Member States. For example, in the United Kingdom poison pills, litigation against the bidder and other defensive measures are not part of the takeover process. Moreover, while it is the case in the United States that a potential bidder can choose when to make its proposal public and there is no deadline for it to make an offer, in the United Kingdom a potential bidder may have news of its plans made public before it is ready to announce, at which point it is required either to announce a firm offer or withdraw within a specific period (the so-called "put up or shut up" rule) and, once a firm offer is made, there is a time limit within which the offer must succeed or fail.

The role of the target board provides another difference between U.S. and European takeover practices. For instance, unlike in the United States, the target board in the United Kingdom is not the first point of contact in an offer context. A bidder may take its offer directly to shareholders and the board is powerless to block or delay a bid in the way it generally can in the United States. In contrast, in France a bidder may approach either the board or shareholders of the target, and the target's board plays a vital role in the offer's acceptance. It is essential for U.S. bidders to understand the custom and practice of M&A transactions in the target country. Understanding when to respect – and when to challenge – a target's sale "process" may be critical. Subtle differences in language, communication expectations and the role of different transaction participants can affect transactions and discussions; preparation and engagement during a transaction must take this into account.

Corporate Governance. As with M&A practice, corporate governance approaches differ both within the European Union and between the European Union and the United States. U.S. businesses looking to invest significantly in Europe will have to consider the disparities between each. U.S. owners of newly-acquired E.U. targets should be mindful of the demands of European corporate governance regimes and ought to familiarize themselves with developing European governance trends such as the increasing focus on board diversity and gender parity. In addition, both foreign and homegrown shareholder activism is on the rise in Europe. Activist campaigns in Europe accounted for 23% of global activity in 2018 and, while this figure is lower than that of 2017, the amount of capital deployed was higher than in the previous year. Defenses such as dual-board structures or super voting rights, once seen as a barrier to activism, are facing mounting challenges – as seen by Elliott Management's acquisition of a €1 billion stake in French drinks group Pernod Ricard, and the hedge fund's criticisms of the Pernod family-heavy board, double-voting rights and lack of board diversity. U.S. activist investors targeting Europe will have to be well versed in the cultural differences and complexities of the corporate governance regime of their chosen country, as well as being prepared to see more competition from homegrown rivals in an increasingly protectionist environment. Equally, U.S. investors not seeking an activist position will need to understand the likely complex web of corporate governance codes and rules applying to their chosen targets, and to be prepared to defend their acquisitions from increasingly-popular activism, if necessary.

Foreign Corrupt Practices Act (FCPA). Before taking office, both President Trump and Securities and Exchange Commission (SEC) Chairman Clayton openly questioned whether FCPA enforcement impedes American business overseas, but Department of Justice and SEC leaders have committed to continued vigorous FCPA enforcement. International cooperation among anti-corruption law enforcement agencies has gathered momentum and new anti-corruption laws are taking effect, with enforcement actions being pursued across Europe. U.S. companies making acquisitions or investments internationally must continue to pay very close attention to FCPA and related anti-corruption risk. Under the FCPA, companies can be held liable for FCPA violations by the target company if they fail to detect, cease and remediate the target company's wrongful conduct. Thus, it is critical that companies do adequate due diligence before acquiring a foreign business, be prepared to mitigate the risk and address any problems if discovered after the fact.

Due Diligence of Foreign Companies. Wholesale application of an acquiror's domestic due diligence standards to a target's jurisdiction can cause delay, waste time and resources or result in missing a problem. Due diligence methods must take into account the target jurisdiction's legal regime and, particularly important in a competitive auction situation, local norms. Many due diligence requests are best channeled through legal or financial intermediaries as opposed to being made directly to the target company. Due diligence requests that appear to the target as particularly unusual or unreasonable (which can often occur in cross-border deals) can easily create friction or cause a bidder to lose credibility. Similarly, missing a significant local issue for lack of jurisdiction-specific knowledge or understanding of local practices can be highly problematic and costly. Prospective acquirors or investors should also be familiar with the legal and regulatory context in Europe and the relevant Member State for diligence areas of increasing focus, including cybersecurity, data privacy and protection and other matters. Diligence relating to compliance with the sanction regulations overseen by the Treasury Department's Office of Foreign Asset Control can also be important for U.S. entities acquiring non-U.S. businesses. In some cases, a potential acquiror may wish to investigate obtaining representation and warranty insurance in connection with a potential transaction, which has been used with increasing frequency as a tool to offset losses resulting from certain breaches of representations and warranties.

FCPA and anti-corruption risk mean additional care must be taken when conducting due diligence on foreign acquisition/investment targets. It is important to consider a target's FCPA risk profile as early as possible in the process. Specific areas to consider include the manner in which the company does business, its industry, and whether that industry is the subject of recent enforcement activity. Also important are the target's reputation and general record for compliance and business integrity. The target's owners, officers and directors should be vetted as well. One way to gather the type of information required for FCPA diligence is for the acquiror to require prospective targets to complete a detailed FCPA questionnaire at the beginning of the process. However, in many instances, the acquiror will be well-advised not to rely solely on information provided. There should be some independent confirmation of details that are critical to the business, such as consultant contracts and third party payments. When reviewing information obtained in the due diligence process, the acquiror should be alert to the discovery of certain red flags which may suggest a higher potential for FCPA violations.

Tax Considerations. Tax legislation enacted in December 2017 fundamentally altered the landscape for U.S. business taxation, effective January 1, 2018, and has had ramifications for U.S. companies investing abroad. Detailed tax modelling will be essential for U.S. companies looking to acquire or invest in European entities. Key statutory changes affecting U.S. companies' foreign operations include:

- Limitations on deductible payments made from U.S. to non-U.S. affiliates in large multinational groups by way of a "base erosion and anti-abuse tax" (BEAT), and disallowance of deductions for certain interest and royalty payments to related non-U.S. parties pursuant to "hybrid" arrangements.
- The new law also made sweeping changes to the U.S. taxation of income earned by non-U.S. subsidiaries of a U.S. corporation by providing for a one-time "transition tax" on the historic earnings of such non-U.S. subsidiary, a 100% deduction for dividends received by a domestic corporation from 10% owned non-U.S. corporations (which may also eliminate tax on gain recognized upon a sale or disposition of a stake in such non-U.S. corporations), and a new minimum tax on earnings of non-U.S. subsidiaries (GILTI).
- Sales of foreign subsidiaries by U.S. corporations now provide greater tax planning opportunities. As any resulting income or gain can be taxed at vastly disparate rates (or indeed not be subject to U.S. tax at all) depending on how it is categorized, minor changes in structure can yield significant tax savings. Sellers and buyers should be mindful, however, that the interplay of the relevant rules is complex, and the results highly fact dependent.
- Some of the most drastic changes have been in the international tax arena, including new rules that generally permit U.S. corporations to repatriate earnings of certain foreign subsidiaries, including earnings taxed under the "transition tax," without additional U.S. tax cost. Whether these rules will have a meaningful impact on off-shore cash levels going forward remains to be seen. Although repatriations reportedly surged in early 2018, recent data suggests that the volume has since dropped to pre-enactment levels.

Antitrust Issues. Cross-border M&A activity is subject to careful review by competition authorities and the European Commission has not been hesitant to challenge or block cross-border mergers and other transactions, even, in rare instances, post-completion. U.S. companies which are considering merging or acquiring a European entity will need to conduct a thorough analysis of any potential competition concerns, considering variations in market conditions and competition law across relevant jurisdictions. Where antitrust issues are engaged, companies should undertake careful planning and engage with competition agencies proactively to minimize any potential difficulties in overcoming antitrust concerns. Over the past few years, the European Commission has been vigorously policing and fining procedural infractions of merger control rules, particularly in instances of "gun jumping" – where companies implement acquisitions before notifying or receiving approval from the Commission. Steadily higher fines are being levied against companies which fall foul of the Commission rules: in 2017, Facebook was fined €110 million for providing misleading information during the Commission's investigation into its acquisition of WhatsApp. It is therefore increasingly important for companies to keep on top of the merger control or investigation process consistently throughout the process and to be mindful of the procedural demands of European antitrust law.

Collaboration. Now more than ever, in the face of current U.S. and European uncertainties, most obstacles to a cross-border deal are best addressed in partnership with local players whose interests are aligned with those of the U.S. acquiror. In an M&A context, if possible, relationships with the target company's management and other local forces should be established well in advance so that political and other concerns can be addressed together, and so that all politicians, regulators and other stakeholders can be approached by the whole group in a consistent, collaborative and cooperative fashion. With advance planning and careful attention to the complex and wide-ranging issues that can accompany cross-border transactions, U.S. businesses can avoid the pitfalls and misunderstandings that can sometimes characterize cross-cultural dealings.