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Structuring cross-border public M&A transactions: key considerations

BY WILL PEARCE, JOSEPH SCRACE AND DOMINIC FOULKES

Given the global nature of the financial and business world, a significant number of M&A transactions are now cross-border in nature. Data published by Refinitiv suggests that cross-border M&A hit an all-time high in 2021 with almost 18,000 deals worth over $2 trillion in aggregate – a stark contrast from just over 3500 deals worth just over $85bn in aggregate in 1991 – with the US and the UK being among the most active nations for cross-border M&A.

When structuring a cross-border public M&A transaction involving a bidder in one jurisdiction and a publicly-traded target company in another, there are a number of key corporate, tax and governance matters that require careful consideration. This is particularly the case where the transaction involves a UK or US incorporated company or the transaction is subject to UK or US rules.

Who is acquiring who?

Broadly speaking, there are three common ways of structuring a cross-border public M&A transaction: (i) Party A can acquire Party B (or merge with Party B and be the surviving entity); (ii) Party B can acquire Party A (or, again, merge with Party A and be the surviving entity); or (iii) a newly formed holding company, Party C, can acquire both Party A and Party B.

Where a larger bidder is acquiring a smaller target, options (i) or (ii) would usually be the default. However, where the transaction involves a combination of two equally sized companies, the parties will need to carefully consider transaction structure. It may be preferable to maintain the jurisdiction of incorporation or listing of one of the companies or to establish the combined group in a new, neutral jurisdiction as per option (iii) above.

Factors that may influence the parties' decision can include the applicable tax regime, corporate law and political sentiment to which a company is subject, the location of business operations and factors relating to the market on which a company is listed, including, for example, eligibility criteria for listing, access to capital, relative valuations, analyst

expertise, peer companies, regulation of directors' remuneration and the nature and extent of continuing obligations, including applicability of takeover regulations.

Legal mechanics to implement the deal

Most cross-border transactions are implemented using one or more of the following legal mechanics: (i) a bidder contractual or tender offer to acquire target shares, often followed by a process to squeeze-out non-accepting target shareholders once a prescribed acceptance or ownership threshold has been met by the bidder; (ii) a legal merger in which the bidder (or a bidder subsidiary) and the target combine as a matter of law, with one legal entity surviving; and (iii) a plan or scheme of arrangement of the target, a process requiring a target shareholder vote and sometimes court sanction, under which target shares are transferred to the bidder.

Whether or not these mechanics are available for use in any particular transaction is determined by the law of incorporation of the target. A legal merger, for example, is common in various US states and in civil law jurisdictions, but is not recognised under English law. For the acquisition of a target traded in a different jurisdiction to where it is incorporated, this can mean the acquisition mechanic differs from that with which its shareholders are most familiar. A UK incorporated company traded in the US, for example, is more likely to be acquired by a UK scheme of arrangement, rather than by way of a legal merger or tender offer process as would be more customary in the US.

Multiple factors will influence the preferred acquisition mechanic, including: (i) the threshold at which ordinary or special control can be secured; (ii) the threshold at which 100 percent ownership can be obtained; (iii) whether a bidder's interests can be voted toward any target shareholder approval; (iv) the legal rights available to dissenting shareholders; (v) the control the bidder has over the transaction process and the speed at which the transaction process can be completed; (vi) the impact of stakebuilding by a bidder; and (vii) whether transfer taxes will be imposed on either party or the transaction.

Determining the applicable rulebook

In addition to the law governing the acquisition mechanic, the target's jurisdiction of incorporation may impose rules governing the way in which public acquisitions must be conducted, for example the Takeover Code in the UK or the tender offer and proxy rules in the US. Even if such rules do not apply as a matter of law, the target's constitution may seek to apply all or part of them. A handful of public companies traded in the UK that are not subject to the Takeover Code have, for example, used their constitutional documents to apply Takeover Code equivalent provisions in order to afford their shareholders particular protections in the event of a takeover.

The target and, if applicable, the bidder, must also consider the rules that apply as a result of their publicly traded status, such as the Financial Conduct Authority's (FCA's) Listing Rules in the UK and the US Securities Act 1933 and New York Stock Exchange (NYSE) or Nasdaq rules in the US, as well as any applicable market abuse or insider trading rules. These rules may require a shareholder vote of the bidder if the transaction is substantial or between related parties or if consideration shares are to be issued to target shareholders. They will also govern any required market disclosures.

It is worth remembering that in a process involving a number of jurisdictions there may be multiple rules applying to the same issue, but with different tests and outcomes. Examples of this may include the threshold or trigger for any leak announcement and the timing and content of any ongoing disclosure of material information. Parties should, therefore, be aware of the need to coordinate on such matters and, in particular, understand which of the applicable rules has the lowest threshold.

Applicable corporate law governing directors' duties will be important, particularly for the target board when deciding whether or not to recommend or, once announced, terminate a transaction. In addition to the corporate aspects of a transaction and key tax considerations, parties will need to consider how antitrust and regulatory clearances, foreign direct investment controls, employment and incentive issues, as well as the terms of each party's material contracts (change of control rights, in particular), might impact and even influence the choice of transaction structure.

Common key tax considerations

Tax issues will be prominent at the deal structuring stage and can have a significant influence on transaction value. Consideration will need to be given to optimising the tax treatment of the transaction itself, and also to the go-forward tax profile of the combined group.

Parties will need to consider whether the transaction can be structured as tax neutral for shareholders, or a significant subset of them – this will often be more sensitive on all-stock combinations. The availability of tax authority rulings to support the parties' analysis should be addressed, and consideration given to the impact of this on deal conditionality, transaction timetable and how the deal is communicated to shareholders. Transfer taxes will also need to be managed: establishing a transfer tax-efficient settlement structure for dual-listed combinations can take careful planning.

Going forward, managing the tax residence of the combined group's holding company will be important in establishing the tax-efficient upstreaming of cash and distributions to shareholders, including the ability to benefit from tax treaties. Where a new jurisdiction is selected as the headquarters' jurisdiction, the impact of extraterritorial tax regimes (such as controlled foreign company (CFC) rules and, increasingly, implementation of the Organisation for Economic Co-operation and Development's (OECD's) Base Erosion & Profit Shifting (BEPS) 'Pillar 2' project) on acquired subsidiaries will need to be diligenced.

The deductibility of interest expense on deal financing, and of other material deal expenses, also remains an important factor in the transaction modelling exercise (particularly in leveraged take-private transactions). The impact of a change of control transaction on preserving valuable tax attributes in the target business may also be relevant.

Documenting the deal terms

Documentation of deal terms will be driven primarily by whether the rulebook that applies to the transaction prescribes a form of, or process including regulatory review and approval for, transaction documents.

For example, in the UK, the primary documentation to acquire a public company subject to the Takeover Code customarily consists of a long form offer announcement, a cooperation agreement (limited to providing assistance to obtain official clearances and the treatment of the target's incentive arrangements) and an offer document or scheme document (as applicable). The content and timing of these documents is highly regulated by the Takeover Code. In the US, however, the primary documentation (assuming a non-hostile situation) customarily consists of a business combination or merger agreement and a proxy statement or tender offer materials (as applicable).

By contrast, there is generally more freedom for the parties to dictate the transaction process in the US than in the UK, and many of the issues which the Takeover Code regulates are customarily addressed contractually in a detailed merger agreement.

A US-style public merger agreement can, for example, include the following provisions that are generally prohibited by the Takeover Code: (i) a 'no-shop' provision subject to a 'fiduciary out', and matching rights; (ii) a target break fee; (iii) endeavours undertakings from the target to satisfy the transaction conditions; (iv) pre-closing restrictive covenants on the target (although the Takeover Code does provide that the target may not take certain actions that may frustrate the bidder's offer without Takeover Panel consent); (v) a financing condition to the transaction (under the Takeover Code an offer must have firm financing in place from announcement); (vi) business warranties accompanied by a disclosure letter (covered to a degree by the Takeover Code in the customary set of offer conditions); and (vii) a contractual standard for invoking conditions to the transaction (invoking a condition is at the discretion of the Takeover Panel, applying a standard set out in the Takeover Code).

Managing the combined group

On an all-stock combination, the composition of the combined group's board and the governance rights (including board representation) of any large shareholder are often agreed at signing or announcement. In certain transactions, governance arrangements may be fixed for an extended period of time after completion through the entrenchment of agreed provisions in a party's constitutional or governance documents.

It is important to agree the treatment of a target's existing incentive arrangements on a change of control and to understand the consequences (if any) of agreeing the terms of any post-completion incentive arrangements (including any required disclosure of or independent shareholder approval that may be required for the arrangements).

In a combination of equals, both parties will also be keen to ensure equal treatment for their respective employees. Further, the feasibility of replicating director incentive arrangements at the board of a company in another jurisdiction should be considered. Shareholder or remuneration committee approval may, for example, be mandated, alongside certain required disclosures to shareholders in order to inform their approval.

Finally, it is increasingly common to see a bidder offer public commitments (such as post-offer undertakings under the Takeover Code in the case of the UK) to maintain a presence of the target (for example tax residency, stock exchange listing, R&D operations, manufacturing facilities and headquarters) in a particular jurisdiction. Sometimes this can assist in de-risking the execution of the transaction from potential political or regulatory challenges and from the risk that target shareholders dissent in any required vote. ■

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