M&A Insights: Cross-Border Transactions, Attorney-Client Privilege and Covenants Not to Compete

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Cross-Border M&A: Trends

- Most surveys reflect an expected slow down in cross-border M&A in the short-term from the record highs of 2021
- Overall long-term trend remains healthy
- We have seen an increase in cross-border carve-out transactions over the past year, which can be attractive in the current market
  - Liquidity generation
  - Narrower focus on core products and services and sale of non-performing or tangential assets
  - Mitigation of supply-chain risks highlighted by the pandemic
- Cross-border M&A is increasingly subject to political considerations and national security scrutiny by CFIUS and its non-U.S. equivalents

Cross-Border M&A: Preparation and Negotiation

- Identify approvals or tasks that may take significant time to obtain or complete
  - Government approvals (e.g., foreign direct investment, competition law)
  - Interaction with unions, works councils and/or pension trustees
  - Financial statement preparation
  - Pre-transaction reorganizations and/or asset transfers
- Develop strategies to address thorny issues upfront
  - Repatriation of cash and treatment of trapped or restricted cash
  - Asset separation (e.g., liability and risk allocation, shared assets)
- Anticipate organizational demands and knowledge gaps, which will inform negotiation of a purchase and sale agreement

Cross-Border M&A: Execution

- Build and hold accountable local advisor teams
  - Preparing thoughtful and manageable scopes of work
  - Non-legal and non-accounting local advisors may be appropriate or necessary
  - Time zone differences
- Recognize legal, cultural and language differences and barriers
  - Answers to legal questions may vary widely even among English-speaking or common-law jurisdictions
  - Management styles may need to be adapted to different legal customs
- Identify and communicate choke points immediately
  - Ministerial tasks may take longer than expected in non-U.S. jurisdictions

Attorney-Client Privilege in M&A: Ownership of Privilege

- In a merger under Delaware law, the Company’s pre-merger attorney-client privilege belongs to the surviving corporation after the merger
  - Contrast with New York law: Buyer controls privilege <u>except</u> for pre-merger communications *relating to the merger*
- Parties are free to contract around the default rule by expressly carving out certain attorney-client communications from the transfer
- In an asset purchase, seller retains pre-closing privilege unless the parties contract otherwise

Attorney-Client Privilege in M&A: Common Interest

- Pre-closing sharing of privileged information between buyer and seller/target – even after signing – runs the risk of waiver
- Common interest can avoid waiver
  - Delaware and (most) federal law: The common interest must involve primarily "legal issues," not just commercial issues
    - Regulatory approval for the merger might qualify
    - Target's contractual exposures might not
  - New York law: In addition, the communication must relate to pending or reasonably anticipated litigation
- Choice of law not necessarily governed by merger agreement

Attorney-Client Privilege in M&A: Best Practices

- Understand the default rules regarding privilege under applicable law
- Specifically negotiate the terms of the transfer of privilege control
  - Carve-out pre-closing deal communications
  - In asset deals, define privileged materials as “Excluded Assets”
  - Limit the buyer’s post-closing use of pre-closing communications
  - Clarify to whom the privilege is assigned (e.g., sellers as a group, the seller representative, etc.)
  - Use of “privilege savings clauses”
- Sellers should be mindful of pre-closing treatment of privileged communications
  - Preserve confidentiality
  - Segregate deal-related communications and attorney work product

Non-Compete Covenants in M&A

- **Ownership-related**: Restrict seller and its affiliates from engaging in competitive business for a period post-closing; generally more liberally enforced

- **Employment-related**: Restrict key employees or other service providers from engaging in competitive business during engagement and for a period post-termination

- **State law governs (currently):** In each case, must appropriately tailor restricted activities, restricted period and covered geography

- **Federal Trade Commission Proposed Rule**: Proposes complete ban on employment-related non-competes (with both employees and independent contractors); non-competes entered in connection with the sale of a business are exempt from the proposed ban where seller is a "substantial" owner

Federal Trade Commission Proposed Non-Compete Ban

- In January 2023, the FTC issued a Notice of Proposed Rulemaking that would ban non-compete clauses as an “unfair method of competition” under Section 5 of the FTC Act
- Defines a non-compete agreement as a contractual term between an employer and a worker that prevents the worker from seeking or accepting employment with a person, or operating a business, after the conclusion of the worker’s employment
- Functional test to determine if a clause is a non-compete agreement under the proposed rule
- Extends to all workers, whether paid or unpaid, and regardless of salary or skill level
- Does not expressly prohibit non-disclosure and IP agreements with employees, but those agreements could be prohibited under the rule if deemed to be written so broadly that they effectively preclude the worder from working in the same field
- Carves out non-competes entered in connection with the sale of a business if the seller has a “substantial” ownership interest (25%) in the business being sold
- If finalized in its current form, companies would be required to rescind existing non-compete agreements within 180 days of the final rule’s publication in the Federal Register

Employment-Related Non-Competes: Rapidly Evolving State Restrictions

- In recent years, states have become increasingly active in regulating the use of restrictive covenants, particularly non-competes.
- The following states have adopted statutes in recent years with restrictions and limitations that could impact the use of restrictive covenants with workers:
  - Colorado
  - Illinois
  - Maine
  - Maryland
  - Massachusetts
  - Nevada
  - New Hampshire
  - Oregon
  - Rhode Island
  - Utah
  - Virginia
  - Washington
- Employment-related covenants entirely or largely invalid in California, North Dakota, Oklahoma, and Washington, D.C.

State Law Trends: Notice Periods, Workforce Limitations, Caps on Restricted Period

- **Notice**: Some states require a separate notice document; many require notice provided 10-14 days before employment commences; some require 3-14 day review period before execution
- **Workforce**: Covenants invalid for lower-wage workers (e.g., annualized earnings <~$100,000 or $15 per hour, earnings less than 200% - 400% federal poverty level, most earnings limits indexed over time); non-exempt workers under the FLSA; those who have not worked at least a specified period after agreement signed
- **Restricted Period**: Some states cap restricted period to 12-18 months post-termination, with most at 12 months

Similar international trends or require consideration at specified percentage of historic pay


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