

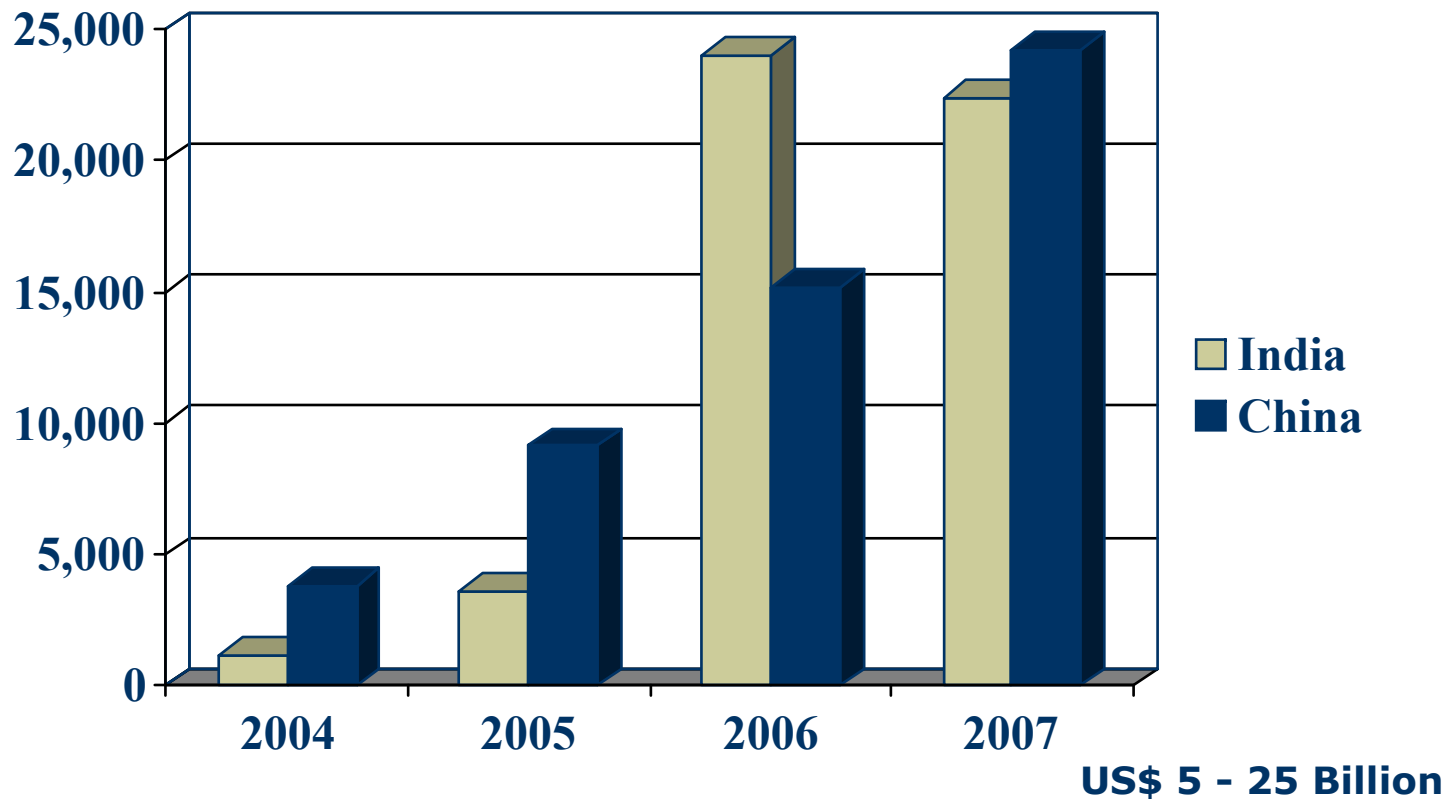
Indian Companies Entering The United States

Key Issues in Acquiring US Companies

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India Outbound Cross-Border M&A



India Outbound Cross-Border M&A

In 2007, the value of foreign acquisitions by Indian companies exceeded that of the combined value of:

- Inbound acquisitions into India, plus
- All other forms of foreign direct investment (FDI) coming into India

Note that the numbers calculated by different sources vary, depending in part on the sources of the figures and the year to which a deal is attributed, such as the Tata-Corus deal. Grant Thornton reports US\$33 billion in outbound acquisitions for 2007

India Outbound Cross-Border M&A

India's outbound acquisitions have been dominated by smaller deals

- ◆ Among US-bound acquisitions by Indian companies in 2007, a group called Virtus Global Partners has estimated that **76% were deals of less than \$25 million**
- ◆ The totals for the US were a relatively small part of the total \$25 billion (\$33 billion?) in Indian outbound acquisitions and the numbers are not scientific, though InternationalCounsel's anecdotal data supports the view that a large percentage of the India-to-US deals are small and often under \$10 million

Indian Company Acquisitions of US Companies -Why?

- ◆ Value of the rupee climbing against the dollar, including pressure on Indian exporting companies
- ◆ Increase in the cost of Indian labor
- ◆ Pressure on Indian companies to continue their growth - which has been at rates approaching 40 percent
- ◆ Through overseas acquisitions, can buy what companies cannot build, including through market and industry expertise

Indian Company Acquisitions of US Companies -Why?

- ◆ Favorable Indian outbound investment policy changes

To further encourage overseas investments, the Reserve Bank of India has liberalized overseas investment restrictions for direct (as well as portfolio) investment:

- Increased overseas direct investment limit from 300 per cent of a company's net worth to 400 per cent of the net worth
- Also allowed Indian residents to remit up to US\$ 2,00,000 per financial year, from US\$ 1,00,000 previously, for any current or capital account transaction

Buying a US Company - Key Structuring and Legal Risk Issues

We want to acquire a US company - are the legal risks too high?



Buying US Companies - Key Issues



1. The US Legal System
2. Foreign Investment Approvals?
3. Stock vs. Asset Purchase
4. US Securities Laws
5. Key Steps in Acquiring a US Company

Buying a US Company - Key Structuring and Legal Risk Issues

1. Overall US Legal System for Buying Companies - Similar to India's?

The US Legal System - Similar to India's?

US state laws are generally applicable to private company acquisition transactions (such as contract law and corporation law)

- ◆ The law of the acquisition agreement and related documents will typically be that of one of the 50 US states
- ◆ Additional US federal laws may apply to other aspects of the acquisition, such as in connection with certain securities, labor, environmental, national security and other areas

The US Legal System - Similar to India's?

- ◆ It is true that the US legal system governing acquisition issues is complex. Yet, foreign investors in a US company will have recourse to US laws and courts (and relatively high enforcement standards) in the event that the target company's management breaches its agreements
- ◆ An Indian party can generally rely on US law and courts and agree to such in the purchase agreement
- ◆ By comparison, a US party purchasing an Indian company may insist on arbitration for dispute resolution given the perceived longer process in Indian courts

Buying a US Company - Key Structuring and Legal Risk Issues

2. US Investment Approvals for Foreign Investors?

US Foreign Investment Approvals?

Unlike for India, China and many countries, the US does not have a general foreign investment approval system that applies to acquisitions and other forms of equity investment

- ◆ Though India is reasonably open to foreign investment, it continues to maintain an approval system. While most industry sectors are open to 100% foreign equity investment through an automatic approval process, a few automatic approval sectors are subject to investment caps, some sectors require investment approval through India's Foreign Investment Promotion Board and some are outright closed to foreign investors

US Foreign Investment Approvals?

- ◆ There are still restrictions that may apply in the US, but these are less common for acquisitions of private companies outside of defense and security industries
- ◆ For example, the US Department of Defense limits foreign ownership of companies involved in defense matters and security clearances may be required in the event of foreign ownership or control
- ◆ Also related to national security, the Exon-Florio regulations may prohibit a foreign company's acquisition of a US company if national security may be impacted

US Foreign Investment Approvals?

- ◆ Apart from the strictly legal implications of US regulations, Indian investors may be concerned about the political dimension of foreign investment
 - In the past few years, deals which failed on political grounds included the attempted acquisition by a Chinese company of a US oil company and a deal involving the transfer of control of certain ports from one foreign company to another which happened to have Middle East origins
- ◆ Yet, acquisitions of privately-held US companies in industries with less of a perceived “national interest” impact do not have such visibility and are much less likely to attract such political attention

Buying a US Company - Key Structuring and Legal Risk Issues

3. Forms of Acquisition in the US

Forms of Acquisition in the US

The primary forms of acquisitions in the US are through stock purchase, asset purchase and merger agreements

US sellers typically prefer stock deals while buyers are generally encouraged to structure transactions as asset acquisitions

A. An Asset Purchase Limits Liability. As an owner of the shares of an existing company, a purchaser of stock assumes its share of liabilities of the target company. An asset purchase, on the other hand, can target only selected key equipment, intellectual property, real estate, etc. Any other liabilities will remain in the target company

Forms of Acquisition in the US

A. An Asset Purchase Limits Liability (continued)

- ◆ All of the company's liabilities will follow the new owner in a stock deal, including employee benefits, tax, environmental and product warranties
- ◆ Such issues can add considerably to the actual acquisition purchase price in the form of unanticipated expenses after the sale if not fully understood

Forms of Acquisition in the US

A. An Asset Purchase Limits Liability (continued)

- ◆ What if someone has been hurt by a product manufactured by the selling company the day before the transaction closes?
- ◆ Has the seller neglected to mention a vendor or other creditor is owed money?
- ◆ As a stock deal, all of these obligations automatically follow the new owner. As an asset acquisition, the buyer's risk is substantially reduced, if not eliminated

Forms of Acquisition in the US

B. An Asset Purchase Can Also Have US Tax Advantages - For the Buyer. In an asset purchase, the buyer is entitled to a "step-up" in the tax basis of the assets being purchased - a later gain would be measured against the value of the assets as purchased

- ◆ In a stock purchase, the buyer may inherit the basis of the selling shareholders, essentially "stepping into the shoes" of the selling shareholders who may have a basis much lower than the value of the stock as purchased. Yet, in a newer company, the increase in value may not be as high with smaller tax consequences

Forms of Acquisition in the US

B. An Asset Purchase Can Also Have US Tax Advantages - For the Buyer (continued)

- ♦ All other things being equal, sellers will usually prefer a stock purchase agreement because of favorable tax consequences. They may be able to realize capital gains treatment on the sale of stock. This avoids "double taxation" that can result with an asset purchase where the business entity is first taxed on sales proceeds, and the shareholders are then taxed again on distributions that may then be made to them

Forms of Acquisition in the US

Asset Purchases Also Have Downsides

- ◆ Stock transfers are simple - mere conveyance of stock certificates and all assets follow
- ◆ In addition, there is no need to specifically assign contracts, permits, licenses, patents, and other intellectual property to the new owner. Nor must any consents be obtained from any third parties to the transaction.
- ◆ The third party may attempt to extract a payment in exchange for the required consent. Other assets (such as franchises, licenses or government approvals) may simply be unassignable

Forms of Acquisition in the US

India in Contrast with the US:

- ◆ ***Bias Toward Stock, Not Asset Purchases.*** There is a bias in India in favor of stock acquisitions - where the stamp duty imposed in asset purchase transactions is still relatively high
- ◆ ***The Purchase Price in a US Acquisition is Whatever is Negotiated and Not Limited by What is "Fair."*** In India, the purchase price cannot be lower than the "fair valuation" of the shares in accordance with Indian valuation guidelines (though even state laws may apply a "fair price" standard to the right of a majority shareholder to "cash out" the minority shareholders)

Buying a US Company - Key Structuring and Legal Risk Issues

4. US Securities Law - A Concern When Acquiring Private Companies?

US Securities Laws

Not as Cumbersome for Private Issuances of Shares

- ◆ US securities laws generally provide that an offering of shares in a US company must be made through a detailed and expensive registration statement unless the offering falls within one of several exceptions.
- ◆ For example, one exception under Regulation S provides that if the sale of securities is to a foreign person in an offshore transaction, and directed selling efforts of the securities are not made in the US, then the offering would be exempt from the usual registration requirements

Buying a US Company - Key Structuring and Legal Risk Issues

5. What Are the Key Steps in Completing a US Acquisition?

Key Completion Steps

Apart from finding and evaluating a US target, setting the purchase price, structuring the transaction and financing the deal, what are the remaining key completion steps in acquiring a US company?

- A. Confidentiality Agreements and Letters of Intent
- B. Keep or Terminate Employees?
- C. Due Diligence
- D. The Acquisition Agreement
- E. Coordinating US and Indian Legal Counsel

A. Confidentiality Agreements and Letters of Intent

US Sellers Will Insist on Confidentiality Agreements

- ◆ To use information and material provided only for deciding whether to buy the business, and not pass along what is provided by seller to anyone other than advisors such as attorney or accountant assisting with the transaction
- ◆ There are standard forms, but an Indian buyer should not sign without good knowledge of the implications and preferably with legal review - can be too broad and needs to have exceptions for information already in hands of buyer, that is public knowledge, etc.

A. Confidentiality Agreements and Letters of Intent

Letters of Intent are Typical

- ◆ Terms include what is being purchased, price, structure, conditions, due diligence (including confidentiality and non-solicitation of employees)
 - The buyer should consider an exclusive dealing or “no shop” clause to prevent the seller from considering other offers while the buyer conducts its legal and accounting due diligence and seeks to negotiate the price and other terms and conditions of the sale
- ◆ “LOI,” “Memorandum of Understanding,” “MOU,” “Heads of Agreement,” - all the same thing. It is an aid in complex negotiations to set out the basic terms yet offer some flexibility

A. Confidentiality Agreements and Letters of Intent

Letters of Intent are Typical (continued)

- ◆ Most terms meant to be non-binding, but take care to be clear on intent of what is to be binding and non-binding to avoid US litigation. The first draft is typically prepared by the buyer, and many do not consult their lawyers
- ◆ Courts will look to whether parties appeared to intend to be bound, whether terms are sufficiently definite to be enforceable. Language should include “This is not a binding or legally enforceable agreement” yet specify aspects that are to be enforceable

B. Keep or Terminate Employees?

The Indian buyer may want to keep the US management team - consider employment or consulting agreements with key people, though easy to terminate others

- ◆ **Keep?** Employees in the United States are far more mobile than employees in most countries. Thus, key employees need to be identified and possibly offered "golden handcuffs" prior to the signing of a stock purchase agreement
- ◆ **Terminate?** On the other hand, most US States provide that employees are "employees-at-will" who can be discharged on short notice without severance benefits, at least so long as the discharge is not challenged as hidden age, race or sex discrimination

B. Keep or Terminate Employees?

The Indian buyer may want to keep the US management team - consider employment or consulting agreements with key people, though easy to terminate others

- ◆ ***Union Issues?*** Union contracts may limit termination options
- ◆ ***Non-Compete?*** An Indian buyer may wish to enforce a non-compete during the term of the employee or consultant relationship and for a period of 1 year or more thereafter
 - As in India, some US states, such as California, do not enforce non-competes beyond the period of employment or consulting

C. Due Diligence

Very Detailed in the US, But Keep it Practical!

- ◆ Due diligence for acquisitions in India and most other countries is not as extensive as in the US
- ◆ Yet, in smaller US transactions, particularly in typical venture capital deals, the process is practical and fast-moving. Attention must be focused on higher-risk issues rather than in analyzing every possible risk area
 - For example, an acquiring company can rely in part on a schedule of exceptions. Representations and warranties can provide that company agreements and other conditions are as disclosed, and exceptions to the general rule can then be included in a schedule

C. Due Diligence

- ◆ Note that even a full due diligence review by an acquiring company is not a substitute for adequate representations and warranties, as well as a legal opinion by the seller's legal counsel
- ◆ This means a real opinion, not one that is so full of exceptions that it is no more than an empty statement on lawyers' letterhead!

D. The Acquisition Agreement

- ◆ Representations and warranties
- ◆ Covenants
- ◆ Closing conditions
- ◆ Remedies
- ◆ Termination
- ◆ Governing law and choice of forum

D. The Acquisition Agreement

Why Not a 1-Page "I Hereby Buy X Company for Y Dollars?"

- ◆ Indian companies are often surprised by the complexity of US acquisition documents and the length and expense of the sale process. What does an Indian company need to know about this process?

D. The Acquisition Agreement

- ◆ US acquisition lawyers take advantage of the flexibility provided by law to negotiate specific representations, warranties, covenants, conditions, termination rights and remedies
- ◆ There are very few statutory implied terms and the agreement is a mini code of law. “Buyer Beware” - unless buyer rights are specified. Short and simple favors the seller.
- ◆ For example, if the acquisition agreement contains an "integration clause", it is unlikely that a US court will imply any representation or warranty to protect the buyer

D. The Acquisition Agreement

Why Extensive Representations and Warranties?

Even if the target company has no pending litigation, the hidden or unidentified danger of litigation could be greater than the net worth of the target company. Substantial damages, including punitive or consequential damages, are a risk for:

- Alleged employee age, race or sex discrimination
- Personal injuries or commercial damages resulting from allegedly defective products

D. The Acquisition Agreement

Risk Reduction Strategies Include:

- ◆ Require seller to represent that no claims exist for specified risks, or claims will not exceed some specified aggregate amount
- ◆ Require the escrow of a portion of the purchase price for some period of time
- ◆ Require seller's personal or bank guarantees
- ◆ Require insurance to cover undisclosed claims

D. The Acquisition Agreement

What are Seller Covenants?

To Preserve the Condition of the Business or Assets Between Signing and Closing, including:

- No actions other than in the ordinary course of business
- No declaration of extraordinary dividends
- No impairing or making unusual dispositions of the target's assets.

E. US and Indian Legal Counsel

Creating an Effective Team - US and Indian Counsel

Are US Legal Costs Too High?

***How to Control Fees Yet Obtain Adequate Protection
from US Acquisition Risks***



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