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The Comfort Trap:

Why US M&A Isn't as Familiar as It Seems

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U.S. private-target M&A may feel familiar to European deal teams, but that comfort can mask a host of stateside pitfalls. Today’s inbound acquisitions must navigate an expanding gauntlet of structuring quirks, U.S. foreign direct investment rules and due diligence traps. This article flags certain key issues that, in our experience, may ambush a European-to-U.S. private-target transaction.¹

Section I of this article addresses the regulation of foreign direct investment as it applies to inbound U.S. M&A; Section II highlights deal structuring topics such as completion accounts, tariff management, tax structuring and securities law considerations in private-company transactions; Section III surveys due diligence flashpoints across numerous traditional due diligence topics; and Section IV provides an in-depth review of recent developments in U.S. law surrounding the use of noncompetition provisions. We have not attempted to be exhaustive but rather to leverage our experience in cross-border transactions to highlight common traps.

¹This article’s scope is limited to private-company transactions. U.S. public M&A brings with it a host of additional considerations.

I. Regulation of Foreign Direct Investment in Inbound Private-Target M&A

A. The Committee on Foreign Investment in the United States

The Committee on Foreign Investment in the United States (CFIUS) is a U.S. government interagency committee that conducts national security reviews of certain foreign investments into U.S. businesses and real estate. CFIUS has jurisdiction to review most inbound M&A transactions and has broad power to mitigate perceived national security risks on a pre- and post-closing basis. It is therefore critical to conduct adequate due diligence and determine early on whether a CFIUS filing is mandatory or, if not mandatory, whether a voluntary filing may be warranted. If a transaction triggers a mandatory filing and the parties do not submit the filing, CFIUS could force a post-closing divestiture and/or impose significant penalties (i.e., a civil penalty of up to \$5 million or the value of the transaction, whichever is greater). Where a filing is not mandatory (and where CFIUS has jurisdiction), CFIUS retains the right to examine the transaction and may require remedies even on a post-closing basis. A CFIUS filing may impact the closing timeline of a transaction, as CFIUS review can range from 30 to 90 days (or longer). Closing while a CFIUS review is pending is generally disfavored and can be prohibited.

As noted above, nearly all inbound U.S. M&A will fall within CFIUS' jurisdiction. This is because CFIUS has jurisdiction to review any investment that may give a foreign person "control" over any U.S. business. For CFIUS purposes, "control" is usually met when the foreign person will obtain any of the following: (i) a voting stake in the U.S. business of more than 10% of the outstanding voting shares, or (ii) a voting stake of 10% or less and a board seat, veto rights, other significant shareholder rights or any other means to determine, direct or decide important matters affecting the U.S. business.

In addition, CFIUS has jurisdiction to review certain noncontrolling investments into U.S. businesses known as "TID U.S. businesses": a critical Technology business, a critical Infrastructure business or a sensitive personal Data business (hence, TID)². CFIUS may also have jurisdiction in other circumstances, including foreign acquisition of the assets of a U.S. business (including assets subject to a bankruptcy proceeding), foreign investment into a joint venture involving a U.S. business, de-SPAC investments, certain convertible debt instruments (if they will confer equity-like rights upon conversion – such instruments are referred to as contingent equity instruments) and other lending transactions (if, as a result of imminent or actual default or other condition, there is a significant

possibility that a non-U.S. lender may acquire control over a U.S. business or qualifying rights over a TID U.S. business). CFIUS may also have jurisdiction to review certain transactions by a foreign person involving U.S. real estate.

Notwithstanding CFIUS' broad jurisdiction, there are only two categories of transactions, each involving TID U.S. businesses, where a CFIUS filing is mandatory: (i) a covered control transaction or covered investment into a "critical technology" U.S. business when the export of the U.S. business's critical technology requires a license or other similar U.S. government permission to pass to the foreign investor, or (ii) a covered control transaction or covered investment into a TID U.S. business when a foreign government has, generally, a 49% or greater interest (direct or indirect) in the foreign investor and the foreign investor receives a 25% or greater interest (direct or indirect) in the U.S. business.

However, even if a CFIUS filing is not mandatory, the parties should conduct a totality of the circumstances review to decide whether to submit a voluntary filing. Parties voluntarily file to potentially obtain a "safe harbor" letter, which, among other things, insulates the transaction from post-closing adverse action by CFIUS. This is significant, as CFIUS can compel a filing at any time, including years after closing if CFIUS did not complete its national security review for that transaction prior to closing. As there is currently no statute of limitations on CFIUS outreach, CFIUS will review the national security risks present at the time of its outreach (as opposed to those present at the time of the acquisition). CFIUS outreach to parties that did not file has been steadily on the rise over the past several years.

If the parties decide to file, they must then decide whether to file the short-form declaration or a full notice. There are pros to each filing, and which filing is appropriate will be based on the particular transaction and its circumstances. While the short-form declaration is less burdensome and subject to a significantly shorter period of review (30 days), CFIUS is not required to complete its review within that period. CFIUS can advise the parties after the 30-day period that they are required to file a full notice, or it may issue a "shrug letter." If a shrug letter is issued, it means that CFIUS did not complete its national security review, but that CFIUS is not taking any further action for the time being and that the parties to an M&A transaction may choose to proceed with closing the transaction. Parties often close on a shrug letter, even though CFIUS could later contact the parties and ask them to submit a CFIUS notice.

It should be noted that CFIUS reviews most transactions without imposing mitigation or opposing the deal in its entirety. Over the past 10 years, CFIUS has imposed mitigation measures and conditions with respect to an average of 13.1% of total notices received (with individual year percentages ranging from 8% to 18% during such period)³. Further, qualitative factors particular to a

²Foreign person investment into a TID U.S. business will be subject to CFIUS jurisdiction when the foreign investor has any equity in the U.S. business (e.g., even a 2% or smaller stake) and acquires one or more "triggering rights." Such triggering rights include (i) a board seat, an observer seat or nomination rights; (ii) access to certain nonpublic technical information in the possession of the TID U.S. business; and/or (iii) involvement in the substantive decision-making regarding the U.S. business's sensitive operations.

³Pursuant to its Annual Reports to Congress for each applicable year, CFIUS adopted mitigation measures and conditions in approximately 12% of total notices in 2024; 18% of total notices in 2023; 18% of total notices in 2022; 11% of total notices in 2021; 12% of total notices in 2020; 14% of total notices in 2019; 13% of total notices in 2018; 12% of total notices in 2017; 13% of total notices in 2016; and 8% of total notices in 2015.

transaction may make the transaction more or less likely to result in risk mitigation action. For example, if a buyer is from or has strong connections with an adversary nation, the transaction may be more likely to pose security concerns and result in CFIUS risk mitigation actions. Further, if the U.S. business is a supplier to the U.S. military, mitigation may be required even for European investors. Each transaction is unique and should be considered accordingly.

B. Foreign Ownership, Control or Influence

“Foreign ownership, control or influence” (FOCI) refers to a situation where a foreign entity has the power to directly or indirectly influence the management or operations of a U.S. company. FOCI has traditionally been a concern for companies involved in sensitive government contracts and was designed to prevent foreign access to classified information. However, FOCI is becoming a concern for an expanding portion of the defense industrial base. The U.S. Department of Defense (DoD) has signaled efforts to expand FOCI disclosure requirements – and potential mitigation – over the next year to include any defense contract or subcontract involving sensitive but unclassified information or whose value exceeds \$5 million. In addition to the formal FOCI program administered by the DoD’s Defense Counterintelligence and Security Agency (DCSA), FOCI must be considered to address and mitigate potential CFIUS risks and export controls risks, among others. For instance, the Feb. 21 “America First Investment Policy” memorandum makes clear that FOCI is a concern for any business involved in an inbound U.S. M&A transaction, particularly if that business will, as a result of such transaction, have exposure to China or if such business is involved in emerging or disruptive dual-use technologies.

U.S. companies are currently recommended but not formally required to proactively address FOCI issues that are not covered by the DCSA. However, FOCI is likely to become more and more significant given the current administration’s investment policy position. Accordingly, European buyers contemplating an inbound U.S. M&A transaction should conduct a FOCI analysis to determine both existing FOCI concerns at the U.S. target company and concerns that may arise as a result of the proposed transaction. If necessary, the buyer should consider mitigation measures that may be taken in connection with or after completion of the

transaction. Guidance published by the DoD provides a helpful framework for navigating these concerns.⁴ This analysis and remediation may include reevaluating subsidiary relationships and any intellectual property (IP) licensing arrangements with China-related entities, transferring voting rights of certain foreign shareholders and board memberships of certain foreign persons to a U.S. citizen residing in the U.S., limiting foreign supply chain dependence, and removing problematic foreign debt and foreign financial obligations. Otherwise, the buyer may face obstacles to closing the deal or demands for significant mitigation before being awarded a defense contract or subcontract.

C. State Restrictions on Foreign Ownership of Land and Real Property

A number of U.S. states have recently enacted legislation regulating foreign investment in U.S. land or real estate – including 22 states during the period from January 2023 to July 2024 alone.⁵ The scope and substance of the applicable laws vary widely among individual states and thus can have different impacts on M&A deals depending on the details of the transaction and the parties involved.⁶ Even though these state laws are not focused on European persons or entities, due diligence should be conducted on a transaction-specific basis to determine any such law’s applicability and impact on the deal. In addition, interested parties should stay vigilant with respect to changes in the jurisprudence regarding such laws as related case law develops; at least one of these laws is currently subject to an ongoing legal challenge in U.S. federal court, and the ultimate ruling on that law may have implications for the enforceability, and possibly even the constitutionality, of similar laws.⁷

D. Reporting to the US Department of Commerce’s Bureau of Economic Analysis

Finally, foreign acquirers of U.S. target companies may be required to submit Form BE-13, Survey of New Foreign Direct Investment, to the Department of Commerce’s Bureau of Economic Analysis (BEA) within 45 days after the consummation of an acquisition for certain foreign investments into the U.S. The information is collected for statistical purposes. There are multiple BE-13 surveys and, thus, it is important to verify which survey is the correct one. For instance, if the total cost of the transaction is greater than \$40 million, a BE-13A, BE-13B or BE-13D may be required; if the cost is

⁴For example, see the DoD’s Office of Small Business Programs’ strategies for mitigating FOCI risk, available at <https://business.defense.gov/Resources/FOCI/>.

⁵Between January 2023 and July 2024, Alabama, Arkansas, Georgia, Florida, Idaho, Indiana, Iowa, Louisiana, Mississippi, Montana, Nebraska, New Hampshire, North Carolina, North Dakota, Ohio, Oklahoma, South Dakota, Tennessee, Utah, Virginia, West Virginia and Wyoming enacted legislation regulating foreign ownership of U.S. land.

⁶Consider, for comparison, (i) a Minnesota law prohibiting anyone but a U.S. citizen, permanent resident alien or business entity that is at least 80% owned by U.S. citizens or permanent resident aliens from acquiring agricultural land (see Minn. Stat. Ann. § 500.221) versus (ii) a Florida law, captioned the “Conveyances to Foreign Entities Act,” which, subject to limited exceptions, prohibits principals with ties to countries of concern (including China, Russia, Iran, North Korea, Cuba, Venezuela and Syria) from owning or acquiring, directly or indirectly (other than a de minimis indirect interest), agricultural land or property located near military installations and critical infrastructure in Florida. The law also generally prohibits any ownership or acquisition of Florida real estate by a Chinese principal (see Florida Statutes, Chapter 692, Part III).

⁷The Florida law referenced above is currently being challenged on various grounds, including that it is preempted by the federal statute underpinning CFIUS. It is unclear when a final judgment will be issued in the case.

⁸Form BE-13 is required to be filed if a given transaction would result in at least 10% of the target company being owned directly or indirectly (including through a newly formed U.S.-domiciled acquisition vehicle) by a foreign entity. The Form BE-13 requirements are agnostic to the form of the acquisition and would apply in the context of asset purchases, share/equity purchases and merger transactions.

\$40 million or less, a BE-13 Claim for Exemption may be the proper survey. Additional ongoing reporting obligations to the BEA will also apply, including, for example, the BE-12 Benchmark Survey: Foreign Direct Investment in the United States, which is conducted every five years.

Deal Structuring Topics

A. Locked Box Versus Completion Accounts: The Advantages of the Completion Accounts Style for the Buyer

When a European buyer is contemplating the acquisition of a U.S. target company, it will have to make a decision about whether to determine the purchase price using the locked box or completion accounts mechanism. Completion accounts mechanisms are nearly universal in U.S. M&A and have distinct advantages for buyers (in addition to being anticipated by most U.S. sellers).

The completion accounts style sets the price for the target based on its value as of the closing of the acquisition. When using the completion accounts mechanism, the parties estimate the purchase price at closing and, if it is determined that the initial estimate was too high or too low, may adjust the purchase price during a specified period after closing in accordance with procedures set forth in the purchase agreement. This differs from a locked box deal, where the price is fixed as of an earlier date, typically the target company's last fiscal year-end (the locked box date), subject only to adjustments, if any, for leakage at closing.

Completion accounts mechanisms can add complexity in terms of drafting and post-closing true-up procedures. That said, the completion accounts style is considered more buyer-friendly than the locked box style because it sidesteps certain problems inherent in a locked box transaction that can result in overpayment for a target. For example, in a locked box deal, the buyer submits an offer based on available due diligence with respect to the target company's value as of the locked box date, even though such due diligence may be incomplete or of limited value; in addition, the seller may have more leverage than the buyer at the offer stage if it is running a sale process in which the buyer must compete with other parties, potentially resulting in the buyer being pressured to submit a higher offer than it otherwise would in order to secure the deal. Each of these scenarios can result in the buyer agreeing to a purchase price in excess of the target company's actual value on the locked box date. Similar problems can arise if there is a change in the target company's value between the locked box date and the closing date. Since the buyer is "locked" in to its purchase price, it will bear the financial risk of any decline in the target company's value during this period, whether resulting from mismanagement,

general economic conditions, specific impacts on the target company's industry (e.g., tariff-related issues, discussed below) or otherwise. With the completion accounts style, the purchase price is determined after a full due diligence inquiry, avoiding the first two issues noted above; further, there are no interim changes in value because the target company is valued as of the date ownership transfers to the buyer, i.e., the closing date. Therefore, the completion accounts style theoretically allows the buyer to minimize the potential for overpayment.

B. Managing Tariffs

Buyers (whether European or American) in M&A transactions should carefully consider whether the risks associated with tariffs that have already been imposed or that may be imposed in the future impact (or have the potential to impact) the revenues and profits of a U.S. target company's business. If there has been or may be a significant impact, it would be prudent to address those risks through various provisions of the acquisition agreement. For example, a buyer may seek an indemnity, tariff-related representations and warranties, a closing condition, or even an earnout, a holdback or a purchase price adjustment if the buyer's risk and/or bargaining power are significant enough. Simultaneously, although tariffs generally do not provide a basis for a material adverse change (MAC)⁹, a buyer should be aware that a seller may seek to modify the definition of a MAC in the purchase agreement to expressly exclude the impact of tariffs as an event or a circumstance that could give rise to a MAC and enable a buyer to terminate the transaction. A buyer should also understand that a seller may attempt to negotiate for greater flexibility in the interim operating covenants in an acquisition agreement in case a new tariff is imposed that would negatively impact the seller's business.

C. Achieving a Step-up in Basis: A Compelling US Tax Advantage of the Asset Purchase Structure

When a European buyer is purchasing a U.S. target company, another key decision will involve what transaction structure to use. Seasoned dealmakers and their attorneys – whether European or American – will be familiar with the usual, nontax-related pros and cons of executing a share/equity purchase transaction versus an asset purchase transaction. Often, stock/equity transactions are simpler because the buyer acquires the target company intact, thereby avoiding certain complexities inherent in asset purchase transactions, particularly transfers of contracts, licenses and other items to the acquiring entity. On the other hand, asset purchase transactions can be favorable in some circumstances because they allow buyers to cherry-pick the liabilities they want to assume from the target company and leave other liabilities behind in the seller entity (provided that the buyer does not unwittingly assume successor liability).¹⁰

⁹ This is because MAC clauses are typically defined to exclude changes resulting from changes in laws, whether pursuant to amendments to existing laws or the promulgation of new laws.

¹⁰ In limited instances, a court may impose "successor liability" on a buyer in an asset purchase transaction. This could cause the buyer to become liable for any number of the target company's liabilities, ranging from debts to legal misconduct (including pursuant to many of the regulations discussed in this article). Although this issue arises most frequently in the acquisition of a distressed target company, buyers considering an asset purchase transaction are encouraged to consult with counsel about the likelihood of this issue.³⁴ § 4(a)(11).

Additionally, in the U.S., the asset purchase structure has a key tax advantage that, usually, does not apply in a share/equity transaction. When a buyer¹¹ purchases assets, it will often receive a “step up” in the cost basis of those assets. The basis of the assets will be equal to the cost, with the result that the total purchase price in an acquisition transaction will be allocated among all the assets acquired in accordance with their relative fair market value. The cost basis associated with the assets after an asset purchase transaction is usually, for complex reasons, more than the cost basis attributed to them prior to the transaction, the increase in cost basis being the step-up. This step-up creates a tax advantage – specifically, the buyer can then use the increased cost basis to take greater depreciation deductions, which offset the new owner’s taxable U.S. federal income and lower its tax liability overall. This sequence can, and often does, result in tax savings for the buyer that can have a cumulative effect over the course of years, as the greater deductions will remain available with respect to the assets for the remainder of their useful lives.

It is not uncommon for the prospect of the associated tax savings to be sufficient to lead a buyer to select the asset purchase structure notwithstanding any greater complexity that it otherwise brings vis-à-vis a stock purchase. Most share/equity purchase transactions do not permit the buyer a post-closing step-up in basis of the assets of the business and, thus, the buyer will forgo greater depreciation deductions and the associated tax savings. That said, in certain instances parties may be able to make a U.S. Code Section 338(h)(10) election, which enables a share/equity purchase transaction to be treated like an asset purchase transaction for tax purposes. While available only in limited circumstances not discussed here, when this election is available, buyers can achieve the tax benefits of an asset purchase transaction together with the relative simplicity of a share/equity purchase transaction.

D. Securities Law Considerations in Private-Company Acquisitions

In a private-company acquisition transaction where the consideration to the U.S. target company’s equity holders will consist of or include securities, federal securities laws, including specifically the U.S. Securities Act of 1933, as amended (Securities Act), may be implicated. The Securities Act requires that all offers and sales of securities be registered with the U.S. Securities and Exchange Commission (SEC) unless there is a private offering exemption available. In certain situations, even where a private offering exemption is available, there may be a regulatory requirement to provide initial public offering (IPO)-level disclosure to each party acquiring a security. In the context of private-company acquisitions, this issue most often arises when the target company’s equity holders (including holders of stock options or other equity incentives) include “nonaccredited investors” entitled to receive a security as part of the transaction consideration.

The most common private offering exemption utilized in M&A transactions is found in Rule 506(b) of Regulation D (Reg D), a safe harbor available under Section 4(a)(2) of the Securities Act. This exemption permits an issuer (i.e., the buyer) to offer securities to an unlimited number of accredited investors and up to 35 nonaccredited investors without having to register the offering with the SEC, assuming certain other conditions are met. However, buyers looking to rely on Rule 506(b) should also be wary of potential pitfalls associated with compliance with the requirements of the rule. For example, even though Reg D permits nonaccredited investors to participate in a Rule 506(b) offering, it mandates that if even a single nonaccredited investor is included in the offering, it will trigger an obligation for the offeror (i.e., the buyer) to provide voluminous IPO-like disclosures to offerees (i.e., equity owners of the target company). Accordingly, Reg D provides a useful exemption only where a target company’s equity holders are all accredited investors (e.g., where they consist entirely of venture funds, institutional investors, high-net-worth individuals or other qualifying investors) or where the transaction cashes out the target company’s nonaccredited investors to avoid issuing securities to them upon the consummation of the transaction, thereby avoiding the need to prepare and provide voluminous disclosures.

In addition, where a buyer is issuing securities as consideration, it should be cognizant of related filing obligations under federal and state securities laws. In the case of securities issued as consideration in an acquisition in reliance on Reg D, the buyer is required to file Form D with the SEC within 15 days and also make certain state-level notice filings (which vary by state and should be determined in advance).

Due Diligence Matters

When conducting due diligence on a U.S. target company, European buyers often encounter issues that are distinctly American in nature, many of which arise from the U.S. dual federal and state legal systems (and from disparities among the 50 states). It would be beyond the scope of any article to capture all these, but the following gives a brief overview of several key topics that frequently come as a surprise to European purchasers.

A. Qualification to Do Business

In the U.S., companies are required to register (often referred to as qualification) in each state where they “do business” (as opposed to a company’s state of incorporation). This is separate and apart from any tax filings or obligations. The types of activities that constitute doing business vary from state to state and will depend on the given state statutes and regulations, as well as any case law developed on the topic. While not exhaustive, typically having employees (including, potentially, remote employees), operations or assets within a state can trigger the requirement to qualify to do business in that state. Thus, it is important to conduct appropriate

¹¹ Note that a European buyer will want to form a U.S. entity to complete any acquisition of the assets of a U.S. business. If a European entity holds the assets directly, it may become subject to U.S. income tax.

due diligence to confirm whether a U.S. target company is qualified in each state where it does business, as there can be financial penalties as well as other legal implications for doing business in a state without properly qualifying.

B. Ownership Determination

For privately held U.S. companies, there is no public commercial registrar or other public listing of ownership. Each company maintains its own lists of its security holders and related records. Such ownership records must be carefully reviewed as part of the due diligence process.

C. Analysis of Shareholder Rights and Protections

Shareholder rights (including notice and consent rights, preemptive rights, tagalong rights, drag-along rights, appraisal rights, etc.) and other protections in the U.S. may be found in a number of different places. They may be codified by the corporate law statutes of the state of incorporation of the U.S. target company or established through related case law,¹² or they may appear in the target company's certificate or articles of incorporation, bylaws and/or various shareholder agreements commonly utilized by privately held U.S. companies to govern the relationship between a corporation and its shareholders.¹³ All these must be reviewed and their interactions with each other assessed to understand requirements in respect of shareholder rights and protections applicable in the context of a given M&A transaction. This analysis may shape transaction structuring, closing conditions and, in some cases, post-closing processes (particularly in respect of appraisal/dissenters' rights) that the buyer will be responsible for managing. Importantly, if the proposed transaction implicates a potential conflict of interest with an officer, a director or a controlling stockholder of the target company, specific steps would be recommended in respect of the approval of such a transaction to minimize the risk of shareholder litigation.

D. Government Contracts

U.S. government contracts differ from traditional commercial contracts in a variety of ways. For example, the government reserves the right to cancel any contract for its convenience, leaving the contractor to recover only the costs incurred to date. Government contractors also must comply with a host of additional regulatory and contractual obligations. These obligations address all aspects of the contractor's business, including subcontracting, supply chain, employment, cybersecurity, accounting and IP. Given these obligations' heightened importance, the government enforces them with stiff penalties. Under the False Claims Act, the government can recover treble damages plus penalties if a contractor falsely certifies that it has complied with the terms of its contract. Likewise, the government can use its suspension and debarment powers to prohibit a company from doing any further

business with the government if it believes doing so will protect the government's interest. Without proper due diligence, the buyer risks inheriting significant liability for the U.S. target company's actions or inactions.

E. Liens

There is no central repository in the U.S. for recording and searching liens; in fact, liens on a company and its assets are recorded and perfected in a number of different ways and in a number of different places. As a general matter, most liens on tangible assets are filed and perfected with the secretary of state of the U.S. target company's jurisdiction of formation and can be searched. Liens on other types of assets are recorded and perfected through other processes; for example, liens on registered IP are recorded with the U.S. Patent and Trademark Office. It is important early in the due diligence process to get a complete understanding of the target company's indebtedness and of liens on the target company's assets so as to enable the buyer to run searches in the right places.

F. Works Made for Hire

In the U.S., a key IP due diligence pitfall is in regard to "works made for hire." Certain works created by an employee or a contractor are owned by the employing company as works made for hire under the U.S. Copyright Act of 1976; however, there are specific requirements that must be satisfied for a work to fall within this classification. Among other things, a work must be created within the scope of employment or, if the work has been made by a contractor, there must be a written agreement specifying that the work is made "for hire" under the statute. Further, there are notable exceptions to what can constitute a work made for hire and the statute would not cover IP that was created prior to the formation of the U.S. target company or prior to the employment/contractor relationship (such as IP made by a founder who then went on to form the target company). In light of this, an important part of IP due diligence with respect to a target company involves identifying (or requesting, as a closing condition) written assignments to the target company of material IP assets (registered and unregistered) to confirm appropriate ownership in the name of the target company and avoid future disputes with founders, employees or contractors.

G. Unregistered IP

In the U.S., certain unregistered IP, such as trade secrets, requires explicit contractual protection and other steps in order for such assets to be protectable IP. A failure by the U.S. target company to take appropriate steps could cause it to lose IP protection status for such assets. Accordingly, the IP due diligence for unregistered proprietary information such as trade secrets requires a review of steps that the target company has taken to maintain those assets.

¹² In the U.S., corporate law is promulgated by the corporate law statutes of a company's state of incorporation or formation and is also developed through court decisions in the respective states (such case law being referred to as common law). State statutory regimes are subject to regular review and amendment, and case law is constantly developing.

¹³ For the sake of brevity, we have assumed at various points in this article that the U.S. target company is a corporation. In the U.S., however, there are additional entity types, including limited liability companies and limited partnerships. Each is subject to its own governing statutes and has its own characteristics that need to be considered but are beyond the scope of this article.

H. Data Privacy

Although the U.S. does not currently have an omnibus data protection law like the EU's General Data Protection Regulation, buyers should be aware that a complex web of federal, state and local privacy and data security laws may be relevant to transactions involving personal data. Among the many legal regimes that may apply are sector-specific laws (e.g., the Health Insurance Portability and Accountability Act for healthcare entities, the Gramm-Leach-Bliley Act for financial institutions), audience-specific laws (e.g., the Children's Online Privacy Protection Act for children's data), activity-specific laws (e.g., the Telephone Consumer Protection Act for telemarketing, the Controlling the Assault of Non-Solicited Pornography And Marketing Act for email marketing) and data-specific laws (e.g., biometric information, credit report information). At the state level, almost half of the states have now enacted their own comprehensive consumer privacy laws that apply to businesses operating in those states and/or processing the personal data of state residents.¹⁴ Further, every state has its own data security breach notification law applicable to unauthorized access to personal information; security breaches can result in significant media scrutiny, regulatory investigations and class action litigation.

Due diligence must therefore be undertaken to understand the U.S. target company's current and historical compliance posture with respect to applicable privacy and data security laws. For example, if the buyer intends to leverage the target company's customer database for marketing purposes, it is essential to confirm that the personal data at issue was collected in accordance with applicable notice and consent requirements. Similarly, public-facing privacy notices and other affirmative representations must be reviewed to understand commitments the buyer may be assuming. Any past noncompliance – including past data security breaches – should be examined closely, as the target company may be subject to pending class action lawsuits, ongoing consent orders or other potentially onerous obligations.

I. Cybersecurity

Similar to data protection, the U.S. has numerous federal and state laws pertaining to cybersecurity. At the federal level, the laws are primarily sectoral (relating to, e.g., healthcare companies or financial institutions). Defense contractors in particular are subject to comprehensive cybersecurity regulations. State-level cybersecurity laws vary among the states. Buyers will want to ensure that they have sufficient contractual protections in place to allocate risks related to any past noncompliance with applicable cybersecurity laws, prior cybersecurity incidents and related consequences (e.g., resulting litigation), and potential future security incidents to the extent caused by a threat actor present in the U.S. target company's network prior to the acquisition transaction.

J. Tax

While tax due diligence is complex and involves numerous issues that are often analyzed by the buyer's accounting firm, one representative U.S. tax due diligence issue arises in the context of an acquisition of the stock of an entity classified for tax purposes as an S corporation. Under the U.S. tax code, an S corporation is a small-business corporation for which an S corporation election is in effect for a given tax year. S corporations are the most common type of corporation in the U.S. and are frequent targets in M&A transactions. Issues arise in connection with these entities because, for reasons discussed below, S corporations can have significant potential tax liabilities, which may not be known at closing and for which the buyer may become responsible if not addressed.

The principal advantage of an S corporation, as opposed to a C corporation (meaning all corporations other than S corporations), is that it enables shareholders to avoid double taxation. S corporations are taxed similarly to partnerships in that they receive "flow-through taxation": the entity's business income (and related deductions, credits and losses) is passed through to its shareholders and reported only on their personal income tax returns and the corporation itself does not generally pay tax. In contrast, a C corporation's income is taxed at the entity level each year, and then if shareholders receive dividends or distributions, those amounts are taxed again as the shareholders' income.

The problem with S corporations is that they are subject to rigid rules under the U.S. tax code, which can be easily and inadvertently violated. To illustrate, an S corporation is permitted to have only one class of stock. If a second class of stock is issued at any point, the S status will fail. If an S election fails for any reason, the corporation will be deemed to be a C corporation for tax purposes and it will owe all related corporate income taxes. It is not uncommon for an S election to have failed for many years, often due to an inadvertent rule violation, resulting in significant past-due tax liability and interest thereon. Therefore, due diligence needs to be conducted to confirm whether the applicable rules have been violated and, if so, as of when.¹⁵

K. Sanctions Compliance

The U.S. Department of the Treasury and the U.S. Department of State administer a number of trade and economic sanctions programs against certain countries and territories as well as certain individuals. U.S. citizens (wherever located), U.S. permanent residents (green card holders), anyone located in the U.S. (regardless of citizenship), foreign branches of U.S. companies and, in some cases, foreign subsidiaries all must comply with the U.S. sanctions regime.

¹⁴ California was the first to enact such a law in 2018; many of the other states (including Colorado, Connecticut, New Jersey, Texas and Virginia) followed the same general contours with respect to notice requirements and consumer rights but with certain notable divergences that may affect companies quite differently depending on specific circumstances.

¹⁵ Buyers, of course, do not want to inherit an S corporation's tax liabilities (which sometimes can be difficult to assess with certainty and, therefore, difficult to quantify pre-closing), and sellers often do not want to provide a related indemnity as the liability could be sizable. Parties often resolve this tension by agreeing to require the U.S. target company to undergo an F reorganization as a condition to the closing of the acquisition transaction. An F reorganization is a complex, multistep internal reorganization that adds several steps to the transaction structure. Since it is not as simple as filling out a form or checking a box, an F reorganization will add costs to a deal. However, a properly conducted F reorganization will cleanse the potential bad S corporation and an acquisition can be made without the related risks outlined above.

Thus, if a foreign buyer does business with any U.S. sanctions target, including but not limited to Iran, Cuba or a person on the List of Specially Designated Nationals and Blocked Persons maintained by the Office of Foreign Assets Control (OFAC), the foreign buyer will need to ensure that its business with a U.S. sanctions target will not involve the U.S. or a U.S. person post-closing. For example, if an English company that does business in Cuba acquires a U.S. company and places that U.S. company's CEO on the English company's board of directors, the parties will need to ensure that certain policies and procedures are in place to wall off the U.S. person from the Cuba-related business.

With respect to the acquired U.S. target company's connection to U.S. sanctions targets, for reasons including successor liability, foreign investors should conduct thorough due diligence on the U.S. business to ensure that it has not engaged and is not engaging in transactions in violation of U.S. sanctions. Liability for violations of OFAC sanctions may be imposed on a strict liability basis, and the penalties for violations are significant: more than \$374,000 or twice the value of the transaction, whichever is greater, per violation in most instances. Further, the statute of limitations permits the U.S. government 10 years from the date of the transaction to pursue a violation.

Sanctions compliance may also be relevant on a post-closing basis, as a matter of integration of the target company into the buyer's broader business and operations. If the foreign buyer does business with countries or individuals within the scope of U.S. sanctions, the buyer may need to take measures to wall off its U.S. entities and operations, as well as its American executives and other personnel, from any such activities or interactions.

L. Export Controls

The U.S. has an array of export controls in place to protect national security interests and promote economic and foreign policy objectives, most notably the International Traffic in Arms Regulations (ITAR)¹⁶ administered and enforced by the Department of State's Directorate of Defense Trade Controls (DDTC)¹⁷ and the Export Administration Regulations (EAR)¹⁸ administered and enforced by the Department of Commerce's Bureau of Industry and Security (BIS). As a general rule, the ITAR has jurisdiction over the export, reexports and transfers (as well as certain temporary imports) of military items and defense services, whereas the EAR covers essentially any technology, software and commodities/hardware (collectively, items) exported from the U.S. not covered by the ITAR.¹⁹ The EAR also has controls on reexports and transfers of U.S.-origin items as well as on certain foreign-produced items. If a U.S. target company's operations involve regulated exports (or

reexports), it will be important for the buyer to determine whether any applicable laws, regulations or policies are implicated by the planned acquisition transaction.

In a stock purchase transaction in which the buyer intends to purchase the target company, or a merger transaction where the target company is the surviving entity, the target company may be required to notify the applicable regulatory agency (or, in some cases, agencies) of the proposed change of control within a certain time frame prior to completing the transaction. For example, a target company that manufactures or exports defense articles subject to the ITAR is required to notify the DDTC at least 60 days before "any intended sale or transfer to a foreign person of ownership or control of the registrant or any entity thereof."²⁰ As a practical matter, any such required notice will require coordination with the foreign buyer, as the disclosure will likely pertain to the proposed new owner. In terms of deal mechanics, the parties will want to make sure the purchase agreement provides for timely notification to the applicable agency(ies), cooperation among the transaction parties and the receipt of any required consents from the agency(ies) prior to closing.

In an asset purchase transaction, or a merger transaction where the target company does not survive, one of two things may be required: Either (i) the target company could be required to transfer its export authorizations, including licenses, to the acquiring entity, or (ii) the acquiring entity may be required to apply for its own export licenses. Processes for transferring such licenses, or obtaining new ones, are often complex and can take several weeks or longer, and the processes for transfers of export licenses are different for each set of regulations. Thus, it is important to understand what export licenses the U.S. business uses and is reliant on and the specific processes and timing required for the transfer of such licenses.²¹ As stated above, the parties will want to anticipate the impact on deal timing and factor the related processes into the related sections of the purchase agreement (e.g., provisions requiring pre-closing cooperation, conditions precedent to closing) as well as ensure that the export licenses are valid for post-closing use.

As may be expected, failure to strictly comply with applicable regulations can result in steep penalties and, more importantly, an inability for the U.S. business to continue to export until the licensing issues have been resolved. This is certainly a business risk any buyer would want to avoid; therefore, buyers are strongly recommended to engage with U.S. counsel and conduct appropriate due diligence on this topic. As with sanctions compliance and other U.S. regulatory compliance, successor

¹⁶ ITAR, 22 C.F.R. Parts 120-130 (2025).

¹⁷ See "Directorate of Defense Trade Controls," U.S. Dep't of State, https://www.pmdtcc.state.gov/ddtc_public/ddtc_public?id=ddtc_public_portal_homepage (last visited Oct. 17, 2025).

¹⁸ EAR, 15 C.F.R. Parts 730-774 (2025).

¹⁹ There are other U.S. government agencies that have export controls license requirements, such as the Nuclear Regulatory Commission and the Drug Enforcement Administration, but those regulations are narrow in the scope of covered items.

²⁰ Notification of changes in information furnished by registrants, 22 C.F.R. § 122.4(b) (2025). Additionally, such target company would be required to notify the DDTC within five days of any change of its name, legal organization structure, board of directors, senior officers, partners or owners, and of any acquisition or divestment of a U.S. or foreign subsidiary or other affiliate, among other types of changes. Any one of the foregoing, or any combination thereof, could be implicated by an M&A transaction.

²¹ 15 CFR § 750.10.

liability applies, meaning that the foreign purchaser can be held liable for violations by the acquired entity even if it did not know about the violations or the applicable export controls laws and regulations. Liability for violations of the EAR may be imposed on a strict liability basis, and the penalties for civil violations are more than \$374,000 or twice the value of the transaction, whichever is greater, per violation. For ITAR violations, which are also prosecuted on a strict liability basis, the penalties are up to \$1 million per violation. Thus, it is paramount to identify any potential violations prior to closing and, if potential violations are identified, it is often strongly recommended to have the U.S. business submit a voluntary self-disclosure to the appropriate U.S. government agency(ies), which may include the DDTC, the BIS and/or the U.S. Department of Justice (DOJ), to ensure that the selling entity remains liable for any violations it committed. The statute of limitations for export controls violations is currently five years. Failure to identify and correct export controls violations prior to closing will almost certainly result in the violations continuing after the sale has closed.

M. Customs and Import Compliance

When the U.S. target company imports goods into the U.S. (whether for manufacturing or for resale), the foreign buyer's due diligence should include an examination of whether the target company is in compliance with U.S. customs laws and regulations. U.S. importers typically rely on customs brokers to handle their declarations of the correct classification, valuation and origin of their imported goods, all of which can affect the amount of duties that are owed. Often, they can become too dependent on customs brokers. U.S. Customs and Border Protection (CBP) requires importers to exercise "reasonable care" for their imports and cannot excuse errors or violations of customs law by blaming customs brokers.

Foreign buyers will want to know whether the target company is the "importer of record" that bears the customs liability for its imported goods or whether it purchases from a distributor or from a foreign manufacturer that assumes that responsibility. For target companies that are the importer of record, due diligence should include questions about potential customs duty liabilities such as whether the company has received penalty notices for incorrect customs declarations, whether the target company is aware of any underpayments of duty or has any voluntary prior disclosures pending to correct underpayments, and the extent to which the target company has received inquiries from CBP about particular shipments or "entries" of goods. The foreign buyer also may want to know the annual volume and value of imports and the magnitude and types of tariffs that apply. Some tariff rates may be settled while others, such as antidumping and countervailing duties, can fluctuate, sometimes dramatically, from one year to the next. The buyer also will want to learn whether the target company has experienced internal customs compliance personnel who are trained and understand the risks associated with high volumes

of imports or whether it leaves those issues to a customs broker, in which case the target company probably is unaware of, and unprepared for, its risk exposure to tariffs.

Due diligence for customs compliance also includes compliance with the laws and regulations of the partner government agencies (PGAs) that CBP enforces. For example, special requirements apply to imported products that are regulated by the U.S. Food and Drug Administration, Environmental Protection Agency, Fish and Wildlife Service, Department of Agriculture, Consumer Product Safety Commission, Federal Communications Commission and other agencies. CBP may enforce the requirements of these agencies, although compliance determinations will be left with the appropriate PGAs. For target companies that depend on large import volumes for their business, foreign buyers may want to verify that appropriate compliance procedures are in place.

N. Foreign Corrupt Practices Act

The Foreign Corrupt Practices Act (FCPA) is a U.S. law that prohibits bribery of foreign officials and requires companies to maintain accurate accounting practices to prevent the concealment of illicit payments. The law has broad extraterritorial reach and is applicable not only to companies that have a presence in the U.S. or employ U.S. nationals, but also when any act in furtherance of the illicit payment takes place in the U.S. The DOJ and SEC have in the past aggressively investigated and pursued FCPA enforcement actions against foreign companies for alleged bribery of foreign officials.

In June 2025, the DOJ announced new priorities for enforcement of the FCPA, targeting conduct that might undermine U.S. corporate access to business opportunities in foreign markets by depriving U.S. entities of fair access to compete or resulting in economic injury to specific American companies or individuals. In particular, the DOJ will prioritize investigations involving foreign bribery in such sectors as defense, intelligence or critical infrastructure. However, any non-U.S. company that competes with U.S. businesses abroad is potentially at risk and should ensure that its anticorruption compliance programs are effective and up to date.

Therefore, it is important for buyers to have a robust due diligence process and compliance program that can identify and remediate any FCPA misconduct. Buyers that promptly and voluntarily disclose criminal misconduct discovered at an acquired company within a safe harbor period, cooperate with the ensuing DOJ investigation, and engage in requisite, timely and appropriate remediation, restitution and disgorgement can avoid U.S. criminal and civil penalties under current DOJ safe harbor policies.

O. Employee Benefits Matters

U.S. employee benefits, including retirement, medical and incentive compensation benefits, are generally established, administered and funded by individual employers (as opposed to government entities)

and are governed by a number of tax and employment laws. This regulatory complexity leads to a number of potential pitfalls, and there can be significant economic impact for noncompliance in this area. Careful review is always warranted, and it is important to identify early in the due diligence process what types of plans are maintained and what funding obligations and liabilities exist with respect to those plans. With respect to executive compensation matters, it is crucial to know whether any seller party will receive payments in connection with the transaction that could be treated as “parachute payments” under Section 280G of the U.S. Internal Revenue Code (IRC). Parachute payments in excess of certain amounts calculated pursuant to Section 280G will subject the recipient to a 20 percent excise tax; in addition, the U.S. target company would not be able to take an otherwise available deduction for such payments. It is also crucial to confirm whether the target company maintains nonqualified deferred compensation arrangements that must comply with Section 409A of the IRC, which strictly governs deferral elections and permissible payment events and imposes immediate income inclusion, a 20 percent additional tax and interest for violations.

P. Wage and Hour Laws; Misclassification

Due diligence regarding employment law compliance is critical when a U.S. target company employs individuals as employees and/or engages independent contractors within the U.S. In the U.S., failure to comply with laws regarding how and when employees are compensated (including whether an employee is paid overtime), paid time off laws, laws protecting various forms of leave time and many others can lead to costly litigation and/or administrative agency investigations and prosecution. Further complicating matters, there is a wide array of state and local laws – especially in states such as California, Colorado, Massachusetts, New York and Washington – that are often more protective of employees than are federal laws and require strict technical compliance to avoid exposure for penalties and other financial consequences.

One specific employment law compliance issue that often comes up involves contractor misclassification. A buyer will want to diligence whether individuals who have been engaged by the target company to provide services as a consultant or an independent contractor rather than as an employee can lawfully be classified as such. Misclassification of an employee as an independent contractor can create significant exposure for unpaid wages, wrongfully withheld benefits and tax liability.

Q. The Worker Adjustment and Retraining Notification Act of 1988 and Mini-WARN Acts

A buyer will want to review the U.S. target company’s past compliance with the Worker Adjustment and Retraining Notification Act (WARN Act) and any similar state-level requirements (mini-WARN acts) and determine whether WARN Act notices or other obligations under mini-WARN acts will be required in connection with the contemplated acquisition transaction.

The WARN Act requires covered employers (those with 100 or more full-time employees and those with 100 or more employees who work a combined total average of 4,000 or more hours per week) to provide 60 days’ advance notice in writing to employees and certain officials, including union representatives, local government officials and state dislocated worker units, in the event of a plant closing or mass layoff, unless certain exceptions apply. Failure to comply with the WARN Act can lead to significant penalties, including back pay and benefits for affected employees, civil penalties, and legal costs, so a buyer will want to be protected from any related risks stemming from the target company’s past noncompliance. It bears noting that during the COVID-19 pandemic many employers implemented temporary or permanent layoffs; buyers would be prudent to give specific attention to the review of any such layoffs to determine whether they implicated the WARN Act and, if so, whether the target company complied with its obligations thereunder.

An acquisition transaction will not necessarily trigger WARN Act obligations for a buyer. WARN Act obligations are not triggered by the acquisition of a U.S. business or workforce alone, as long as the target company’s workforce will have continued employment following the acquisition. However, if the acquisition will result in a plant closing or mass layoff, the buyer may incur WARN Act obligations and compliance therewith should be considered as a matter of deal planning.

The scope and substance of mini-WARN acts varies greatly among individual U.S. states and, therefore, should be considered separately depending on the facts applicable to the specific transaction.

To date, more than 20 states (and municipal jurisdictions) have some type of mini-WARN act, ranging from regulations encouraging employers to provide notice to local entities or affected employees for aiding workforce displacement assistance to statutes requiring employers to provide severance pay or obtain authority before ceasing or limiting operations. State requirements often apply to layoffs affecting fewer employees than the WARN Act requires or to employment losses that may fall within an exception to the WARN Act. Therefore, it is necessary to also evaluate potential exposure from state or local laws in any acquisition-related employment loss.

R. Owned Real Property

Title review is one of the most important due diligence exercises relating to a transfer of the ownership interests in real property. Whether a buyer is obtaining indirect ownership through a stock deal or directly via an asset purchase transaction, it is necessary to confirm and identify the current owner(s), the form of ownership, the actual parcel of property being purchased, and any encumbrances, conditions, restrictions, limitations or servitudes benefiting or burdening the property. As part of the title review process, a buyer will need to acquire the applicable records pertaining to a parcel of real property from the applicable recording

office in order to assess these and other key due diligence items; however, acquiring such records can be a complicated process due to labyrinthine real property recordkeeping systems utilized in the U.S.

Similar in many ways to the lack of a centralized commercial registrar, the U.S. does not have a centralized federal registry for privately held real property. Land records are generally maintained at the state and local levels, and the exact bodies responsible for accepting, recording, filing and maintaining the applicable land records differ from state to state and locality to locality (though they generally consist of city and county clerk's offices and registrars). Given the complexity, buyers often entrust these searches to their attorneys or a title insurance company, each of which can provide reports of documents and instruments of record and, in the case of a title company, will issue an insurance policy insuring the ownership of the property and any matters affecting title at the date of issuance.

It may also be prudent for a buyer to obtain and review additional items, such as land surveys or third-party reports relating to zoning, environmental matters, etc. In some cases, a buyer may find it sufficient to rely on items previously procured by the seller; however, in cases where a buyer is recommended to or chooses to undertake a de novo review, the buyer may have to contend with impacts on deal timing, as these reports can take several weeks to finalize.

Finally, it should be noted that many U.S. states and localities impose taxes on the transfer of real property, both through direct (asset purchase transaction) transfers and indirect (share purchase transaction) transfers, the responsibility for which should be allocated between the buyer and seller in the purchase agreement.

S. Environmental Laws

Environmental risks can be significant in the U.S., especially where there are ongoing remediation or removal efforts under the federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). Successor liability can attach to these properties, even in the case of an M&A transaction structured as an asset purchase transaction. Therefore, due diligence must be conducted to understand historical or current contamination of properties utilized in the U.S. target company's business, whether owned or leased. Given recent federal and state laws addressing emerging contaminants, it can also be worthwhile to consider substances that may be more broadly regulated in the future.

In the U.S., there is generally a two-tier process for conducting an environmental review of a property: a Phase I environmental site assessment (ESA) and a Phase II ESA. These reviews are conducted by specialized firms that then prepare reports for the client's and its counsel's review. The Phase I ESA aims to identify potential environmental liabilities, called recognized environmental conditions (RECs), and risks associated with a property based on its historical and current uses. It is nonintrusive and focuses

on record review, site reconnaissance and, potentially, interviews. Where a Phase I ESA identifies RECs, it is advisable to conduct a Phase II ESA. The purpose of a Phase II ESA is to confirm and quantify the presence and extent of identified RECs. This assessment is intrusive and may consist of sampling, testing and laboratory analysis. The information collected in this two-tier review can be of particular benefit to a prospective buyer, particularly in an asset purchase transaction where the buyer does not wish to assume liabilities related to environmental law compliance. For instance, the data obtained in a Phase I ESA can be used to satisfy CERCLA's "all appropriate inquiry" requirements, which can help a buyer establish the "innocent landowner defense," thereby providing some protection from liability for preexisting environmental contamination. (Thus, it is imperative that the buyer ensure that the Phase I ESA meets all the required elements of the all-appropriate inquiry standard.)

Should a buyer seek to utilize a Phase I ESA report provided by the seller of a property, the buyer must be identified in a Phase I ESA report update as a party that can rely on the report. Alternatively, the buyer can request a reliance letter to the same effect from the consultant that performed the Phase I ESA. Phase I ESAs must be performed within 180 days of a purchase. If one has been completed within the previous year, it may be possible to update the Phase I ESA rather than conduct an entirely new ESA. However, it is important to note that if a Phase I ESA lapses by more than a year, it cannot be used to establish the bona fide buyer defense available under the Brownfields Act, a federal law designed to encourage the cleanup and redevelopment of contaminated properties by limiting liability for certain buyers. It is vital that a buyer be able to rely on the Phase I ESA report.

IV. Noncompetition Provisions

Obtaining enforceable noncompetition covenants from sellers is an important element of M&A transactions in order to preserve the benefit of the bargain for the buyer of a U.S. business. In the U.S., the enforceability of noncompetes is governed by the laws of the 50 states plus the District of Columbia rather than at the federal level, necessitating a careful analysis of which states' laws may potentially apply and the best course of action given the facts and circumstances. In 2024, the U.S. Federal Trade Commission (FTC) sought to implement a much-publicized federal rule that aimed to ban employment noncompetes nationwide, with limited exceptions. However, before the rule could become effective, federal courts in Texas and Florida issued injunctions blocking its enforcement. The FTC has abandoned its pursuit of this rule, having come under new leadership after the 2024 U.S. presidential election.

Courts in Delaware (whose law is often selected as the governing law for corporate, transactional and investment fund documents) will uphold noncompetes if they (i) are reasonable in scope and duration, (ii) protect a legitimate economic interest of the party seeking enforcement, and, on balance, (iii) are fair when viewed

together with the potential harm that could be caused to the restricted individual. Historically, Delaware routinely upheld (i) sale noncompetes with a five-year duration from the date of closing involving a geographic scope no greater than that in which the target engaged in business just prior to the acquisition, and (ii) employment noncompetes (often negotiated with continuing executives or other employees of the U.S. target company in the M&A context, in addition to sale noncompetes) with a much shorter duration but keyed off the termination of the employment relationship, which could come much later.²²

However, the Delaware Court of Chancery has shown, in a series of decisions over the past few years, that it is willing to strike down overly broad restrictive covenants even when those have been mutually agreed to by sophisticated parties as part of a sale-of-business transaction. Where a contractual provision is found to be unenforceable, courts may either strike it down altogether or “blue pencil” it, which means they may enforce a narrower version of the negotiated provision. The Court of Chancery recently struck down a string of noncompetes that the court determined were not reasonable in geographic scope or temporal duration and declined to blue-pencil the offending language. This puts the onus on the parties to draft enforceable provisions at the outset rather than rely on the courts to enforce an overly broad noncompete to the greatest extent they are willing to.

Moreover, while Delaware will generally uphold a contractual choice of law provision, the Court of Chancery has recently declined to do so where enforcement of the noncompete would subvert a fundamental public policy of a different state whose interests in the matter outweigh those of Delaware. Courts may be more apt to apply, instead of the mutually agreed state’s law, the law of the state where the employee works or where the employer is located, or a third state if for some reason the state determines such third state has the most significant interest in the matter given the facts and circumstances.

In this context, it is prudent for acquirers to seek noncompetes that are well tailored to survive review under the laws of such states as may reasonably be deemed applicable in the event of a dispute, as well as to adopt such other enforceable restrictive covenants as may help protect their trade secrets, confidential information and investments in human capital. Such additional protective provisions may include forfeiture-for-competition provisions, which the Delaware Supreme Court has ruled are not subject to the same “reasonableness” analysis applicable to noncompetes, as well as nonsolicitation and nondisclosure covenants.

A number of states have adopted statutory limitations on noncompetes, most notably California, with other states limiting the use of noncompetes with respect to certain subsets of workers, such as those in the healthcare industry or those earning lower wages. A bill to ban employment noncompetes for all but highly compensated individuals is being considered by the New York State Legislature. Accordingly, buyers acquiring a U.S. business will have to interact with highly variable state laws in order to understand what is permitted in connection with any agreements they wish to implement with sellers, executives and employees at the closing of an acquisition transaction.

V. Conclusion

In sum, the U.S. has become an increasingly complex landscape for cross-border M&A. With clear and current advice, pitfalls can be navigated, surprises can be avoided and, in some cases, these topics can even work to a buyer’s advantage.

²² In our experience, it is common for buyers to overreach during negotiations, particularly by requesting an overbroad geographic scope, i.e., nationwide, when the target company only does business in a handful of states.

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