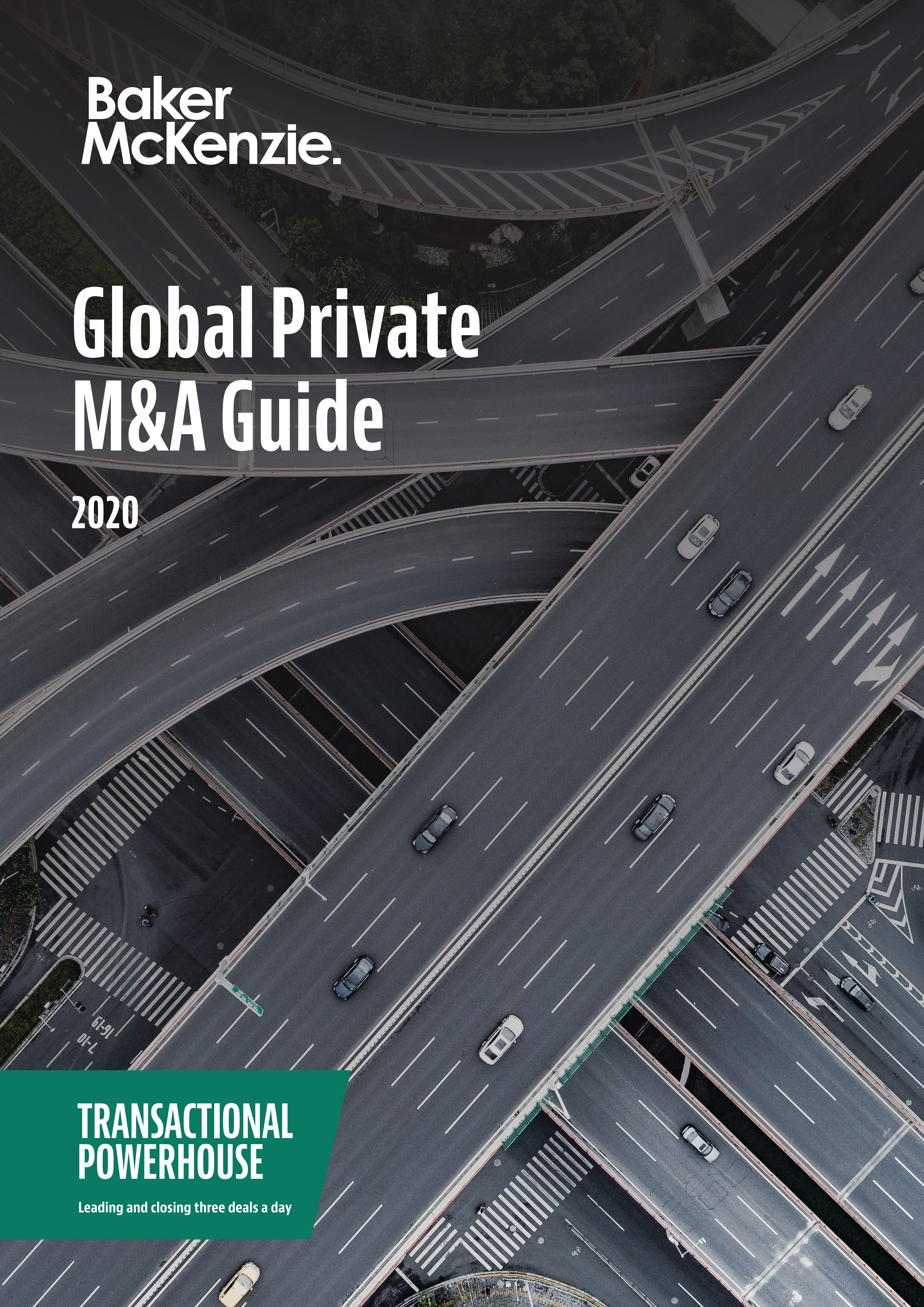

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Global Private M&A Guide

2020

TRANSACTIONAL POWERHOUSE

Leading and closing three deals a day

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Due diligence

In Argentina, regulatory non-compliance is very common. For example, in the context of labor, the underpayment of social security for employees, the violation of overtime policies, and the misclassification or improper registration of employees may involve penalties from tax and social security authorities. Breaches of environmental laws are also common. Often, such non-compliance will mean additional costs for rectification and operations post-closing. These issues may erode deal value and in some situations may cause the buyer to walk away from the deal.

In some jurisdictions, asking the seller to clean up/rectify the issues before closing will be the norm. However, this is not necessarily the case for every situation in Argentina. Coming up with an appropriate solution requires detailed due diligence and a deep understanding of the local practice and practical risks involved. It may be advisable to seek protection through a reduction in the purchase price, extended warranty periods or a retention of the purchase price.

Signing/closing

A deposit is not required. Transactions may be structured with simultaneous signing and closing. However, parties may agree to certain conditions precedent or the transaction may be subject to certain mandatory approvals that may require a separation between signing and closing.

Asset sales

The purchase of all or a substantial part of the assets of a company is considered a transfer of a going concern (*transferencia de fondo de comercio*) or a bulk transfer. When the sale of assets implies the transfer of an ongoing concern, all liabilities of the ongoing concern will be transferred with it, unless the specific procedure set forth in the Argentine Bulk Transfer Law Number 11,867 is followed. The application of the provisions of this law is not mandatory, but can be voluntarily opted into where the buyer wants assurance that the liabilities transferred to it do not exceed those declared by the seller. The main purpose of this legal procedure is to protect the buyer from any hidden and contingent liabilities and to protect the seller's creditors in cases where the seller is transferring a substantial part of its assets. Nevertheless, some labor and tax liabilities will pass to the buyer, and the buyer will be jointly and severally liable with the seller for these obligations.

Approvals/registrations

Subject to certain exceptions as indicated below, no prior governmental approval is necessary other than the authorizations needed for any domestic or foreign investor engaged in a particular business activity. Specific authorizations are common in the banking, insurance and pharmaceutical industries.

Foreign investment

Argentine law requires that each foreign company register with a Public Registry ("**PR**") in order to become either a shareholder of a local corporation (*sociedad anónima* or SA) or a quotaholder of a local limited liability company (*sociedad de responsabilidad limitada* or SRL). Comments on the local PR in this guide will consider only the PR of the City of Buenos Aires. The foreign company must file certain corporate and accounting documents with the PR, including (i) articles of incorporation and bylaws, (ii) a board of directors' resolution stating the foreign company's decision to act as a foreign equity holder of an Argentine company, (iii) a power of attorney appointing a legal representative in Argentina, (iv) financial statements or information of non-current assets placed outside Argentina, and (v) a certificate of good standing issued by the appropriate government authority. In the case of an acquisition of all of the capital of a corporation or limited liability company, the buyer must register at least two shareholders or quotaholders, respectively. Only in the case of corporations could the local entity be or become a sole shareholder company, in which case only one shareholder would be required. Although registration is not required before closing, the buyer must comply with this requirement promptly after closing to enable the local acquired entity to function correctly. Certain corporate decisions will not be effective until the foreign company is registered with the PR. It can take between three and five weeks to register a foreign entity as a shareholder or quotaholder with the PR.

Merger control

The merger control regime is governed by the Defense of Competition Law No. 27,442 ("**DCL**"). The Competition Defense Commission is the enforcement regulator for the merger control regime.

The Commission must be notified of any merger that meets the statutory definition of 'merger,' taking into account the size of the transaction and its territorial reach. The following transactions are within the scope of the DCL and therefore require that notice be provided to the Commission: (i) mergers of previously independent entities; (ii) transfers of ongoing concerns; (iii) the acquisition of ownership rights in shares or equity interests, debts, or any other rights in shares or equity interests that may entitle the holder to convert them into shares or equity participation, or have the control, or a significant influence, over the internal decision-making process of the entity issuing them; and (iv) any other agreement or transaction that may transfer to any entity or economic group the assets of another entity, or grant to that entity or economic group the control of, or a significant influence on, the adoption of ordinary or extraordinary business decisions of the entity.

Any of the above transactions must be reported to the Commission when the cumulative annual turnover in Argentina of the parties involved exceeds ARS 4,061,000,000 (approximately USD 56 million). This amount is fixed in adjustable units and updated on a yearly basis. For the purpose of this calculation, annual turnover means annual turnover in Argentina of the acquiring group companies plus the turnover of the target company, explicitly excluding the seller's turnover.

'Cumulative business volume' means the total gross ordinary sales of goods and services (locally and through exports) of the newly combined entity during its last financial year, less any discount on sales, VAT and any other taxes directly related to business volume. Cumulative business volume is calculated taking into consideration direct sales of the acquired entity itself, plus sales of any entity in which the acquiring group has significant interests.

Certain detailed rules apply with respect to determining whether a transaction must be notified or is exempt from the notification requirement. When deciding whether to notify the Commission of a proposed merger, the facts must be analyzed and referred to the Commission on a case-by-case basis. The DCL includes the obligation to pay a filing fee of between ARS 203,050 and ARS 812,200 (approximately between USD 2,800 and USD 11,300); the amount shall be determined by the National Executive Branch and will be adjusted on a yearly basis.

Non-compliance with notification requirements may result in fines of up to 0.1% of the consolidated Argentine annual turnover of the economic groups involved, per day of delay registered during the last fiscal year until the required notification is filed. If the previous criterion cannot be applied, the fine may be up to ARS 30.5 million (approximately USD 420,000) per day of delay, according to the current value fixed to adjustable units. The days will be computed from the day in which the obligation to notify the economic concentration became due or since the taking of control was completed.

Notification to the Commission must be filed: (i) before the merger is executed; (ii) within one week of the date the agreement is executed; (iii) within one week of the date of publication of the purchase offer; or (iv) within one week of the date of acquisition of a controlling participation, whichever occurs first. In the case of the acquisition of shares, one week starts to run as of the date when the acquisition of the ownership rights over the shares becomes effective, as defined in the share purchase agreement. This means, in practice, that notification may take place up to one week from closing.

The Commission has established that, in some circumstances, transactions that are subject to mandatory filing may be closed before approval but that they will not have any effect between the parties or vis-à-vis third parties until such approval is granted. From a practical point of view, it is difficult to determine the effects of this interpretation in the case of a transaction which has already been closed and authorization for which is later denied. However, in controversial cases (e.g., a transaction that would give rise to significant concentration in the market), it is advisable not to close before approval is obtained to avoid these uncertainties.

Having said this, one year after the new competition authorities are appointed, a pre-merger system will enter into force by means of which filing must take place before control is acquired. The DCL does not specify on the way the pre-merger system will be implemented and we expect the new authorities to issue guidelines on gun-jumping to clarify. In this regard, when such pre-merger system enters into force, filing must take place prior to any agreement or action that may constitute an acquisition of control.

It typically takes one year or more to obtain clearance from the Commission due to the many questions made by the Commission that interrupt the 45-day approval period set out in the DCL.

Other regulatory or government approvals

Argentine regulations establish limitations on the acquisition of real estate located on land designated as "Rural Land" or a "Security Area." Foreign buyers, either in asset or share deals, must obtain approval from the Rural Land Register and/or the Security Areas Agency, depending on whether the real estate is affected by one or both regulatory limitations. Restrictions may apply depending on the deal structure, the amount of hectares involved and the location of the real estate. Approval by the relevant authorities for this type of transaction may take several months.

In other specific industries, such as oil and gas, prior approval from regulatory authorities may be required prior to closing in relation to asset deals.

Employment

Acquisition of shares: If the buyer acquires a company through an acquisition of shares and the target continues as the same legal entity, the buyer's liabilities or duties will be the same as those of the target. In addition, the Employment Contract Law ("**ECL**") establishes that the seller and buyer will be jointly and severally liable for all labor obligations existing on the date of the transfer of any entity to another company. The ECL does not require the provision of notice to employees or unions.

Transfer of assets in bulk (*transferencia de fondo de comercio*): Where the assets and the employees transfer together contemporaneously from one company to another, there is no legal obligation to provide notice to employees regarding the transfer or to obtain employees' consent. The employees transfer automatically.

A change of employment terms and conditions at or after transfer — if it implies material and/or non-material (in the form of pain and suffering) detriment — may serve as grounds for a constructive dismissal claim. Such a claim could be made against the buyer and seller jointly and severally if the change occurs at the time of or immediately after transfer, or against the acquiring company if the change occurs once the relationship with such company is consolidated.

Transfer of assets on a sequential basis: Where the assets and the employees do not transfer together contemporaneously from one company to another, but rather at different stages, notice must be provided to employees regarding the assignment of their contracts and their consent must be obtained. The employees do not transfer to the buyer automatically.

Employees may refuse to have their contracts assigned to the buyer without providing specific reasons. In such event, an employee would be entitled to severance for termination, for which, in principle, the seller would be liable; it is irrelevant whether there are changes to employment terms and conditions upon assignment.

Tax

Share purchase agreements with effect within the jurisdiction of the City of Buenos Aires are subject to stamp tax at the rate of 1% on the 'economic value' of the transaction. Share purchase agreements with effect in other provinces are subject to a stamp tax of approximately 1.5%, although the rate varies depending on each jurisdiction.

Executing the agreement by means of an offer/acceptance mechanism is a valid and widely accepted method of avoiding this stamp tax. This mechanism makes the agreement non-taxable for stamp tax purposes and enforceable. It consists of one party sending an offer to enter into an SPA with all the terms and conditions and the other party accepting such offer by a separate acceptance letter or by the performance of a positive act (e.g., payment of a symbolic amount).

This mechanism has been validated by Argentina's Supreme Court but there are certain provinces with a more aggressive approach that may request payment of the stamp tax when the agreement produces effects in their jurisdiction.

In addition, the transfer of shares in an Argentine entity held by non-Argentine shareholders will, in principle, be subject — at the sellers' choice — to a 13.5% withholding tax on the sale price of the shares or a 15% tax on the net gain (i.e., sale price less tax cost of the shares) obtained by the seller.

According to domestic law, when both the seller and the buyer are foreign, the tax must be withheld and paid to the Argentine tax authorities. However, from a practical standpoint, the withholding tax is currently not applicable due to the fact that the payment procedure for the foreign buyer to pay the tax has not been implemented. Thus, in this scenario the tax is currently not payable and will not become payable unless such a payment procedure is put in place before the transfer becomes time barred.

If the shares are held by an Argentine individual, the applicable withholding tax is 15%. When the seller is a local entity, the applicable income tax will be 35%.

From a procedural standpoint, the Argentine entity whose shares are being transferred will have to inform the Argentine tax authorities of the transfer of its shares within 10 business days as of the closing date.Such transfer takes place through the tax authorities' website.

Stamp tax will also apply in the case of an asset transfer. In addition, notary fees and costs are payable on transfers of real estate at variable, negotiable rates, capped at approximately 2.3% of the value of the land.

Post-acquisition integration

N/A

Common deal structures

What are the key private M&A deal structures?

The legal framework differs significantly depending on whether the transaction is structured as a merger, a purchase of assets or a purchase of shares/quotas.

Both share and asset deals are common. Acquisitions via share purchase may take place through the issuance of new shares/quotas or through the purchase of existing shares/quotas. If new shares are issued, the capital contributions are made to the company and not to its shareholders or partners. If existing shares are purchased, the payment is made to the selling shareholder/partners.

In Argentina, there are two ways to undertake a transfer of assets: (i) by means of the transfer of the individual assets; or (ii) by means of the transfer of a commercial establishment or a going concern.

The auction bid process is more common for major projects deals, depending on the size of the deal and the sophistication of the seller. Bid process letters are used. It is more common to use indicative bid letters that are non-binding.

Under Argentine law, two or more companies can merge by either consolidation or absorption. In both cases, the company surviving the merger acquires, as universal successor, all the assets and liabilities of the companies and the companies are dissolved without being wound up. As a result, the shareholders of the companies become shareholders of the surviving company in accordance with the share exchange mechanism agreed upon between the merging companies.

The main difference between the two merger procedures lies in the nature of the surviving company. Under the consolidation process, the merging companies are succeeded by a newly formed company, while in the absorption process, an existing company is absorbed by the surviving company.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

Argentine law provides for several types of legal entities. The most common types of entities are the stock corporation (*sociedad anónima*) and the limited liability company (*sociedad de responsabilidad limitada*), which are subject to different corporate requirements.

What are the different types of limited liability companies?

Stock corporations and limited liabilities companies are the two most commonly used private companies. Shareholders of stock corporations and quotaholders of limited liabilities companies are not, in principle, liable for corporate debts and obligations beyond the amounts due to pay in, based on the capital subscribed, unless certain circumstances related to fraud are met.

The main difference between quotas and shares is that quotas are not represented in certificates. All quotas must be subscribed upon incorporation. Quotas are freely transferred by assignment unless the bylaws provide otherwise and such transfers must be registered with the public registry (PR) in order to be enforceable against third parties.

The managers of limited liability companies have the same rights and obligations as the directors of stock corporations and may or may not be quotaholders.

Unlike stock corporations, it is not mandatory for a limited liability company to have a minimum corporate capital but the level of capital must be deemed reasonable to conduct the company's business activities. Capital is represented by quotas, all of which must have the same face value and must grant their quotaholders one vote per quota. All quotas must be subscribed upon incorporation and the quotaholders must pay in all contributions in kind and at least 25% of their cash contributions. The remaining 75% of the cash contributions must be paid in within two years of the date of incorporation.

As regards the stock corporations, capital is represented in shares. The bylaws may provide for classes of shares, which may be entitled to different rights. Shares of the same class must have equal rights. The minimum capital requirement is ARS 100,000 (approximately USD 1,500 at the current exchange rate), although the PR may request a higher capital. Capital must be reasonable to perform the corporate purpose. Upon incorporation, the shareholders shall have paid in all of their contributions in kind and at least 25% of their contributions in cash. The remaining cash contributions must be paid within two years from the incorporation date.

Is there a restriction on shareholder numbers?

Stock corporations can be incorporated with one shareholder whilst stock corporations with multiple shareholders need at least two shareholders with no limit on the maximum number. Limited liability companies must have at least two quotaholders and a maximum of 50 quotaholders.

What are the key features of a share sale and purchase?

Acquisitions via share purchase may take place through the issuance of new shares/quotas or through the purchase of existing shares/quotas. If new shares are issued, the capital contributions are made to the company and not to its shareholders or partners. If existing shares are purchased, the payment is made to the selling shareholder/partners. If a foreign company plans to acquire shares or quotas in Argentine commercial companies, the foreign legal entity must be registered with an Argentine public registry (PR). Foreign legal entities applying for registration with the PR must comply with the following criteria: (a) the entity performs significant economic business activity outside Argentina; and (b) the entity is not restricted to conduct businesses solely outside of its place of registration.

What are the key features of an asset sale and purchase?

The purchase of all or a substantial part of the assets of a company should be regarded as a transfer of a going concern (*transferencia de fondo de comercio*) or 'bulk transfer'. Transfers of going concerns are specifically governed by Law No. 11,867. The application of the provisions of this law is not mandatory, but can be voluntarily opted into where the buyer wants to be assured that the liabilities of the seller transferred to the buyer do not exceed those declared to the buyer by the seller. The main purpose of this legal procedure is to protect the buyer from the seller's hidden and contingent liabilities, and to protect the seller's creditors in cases where the seller is transferring a substantial part of its assets. Nevertheless, labor and some tax liabilities and contingencies will pass to the buyer, which will be jointly and severally liable with the seller for these obligations. The purchase price may not be lower than those reported liabilities (Law No. 11,867).

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

Yes, it is customary to prepare a letter of intent or term sheet. They can be binding or non-binding, although most are binding with respect to exclusivity and confidentiality obligations. For non-binding letters of intent or term sheets, the parties must conduct negotiations and otherwise act in good faith pursuant to Argentine law. The unjustified failure of negotiations could constitute a breach of this duty of good faith during pre-contractual negotiations. That is, the abusive conduct of one of the negotiating parties in violation of the requirement of good faith negotiation may create pre-contractual liability.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: Most term sheets include provisions on exclusivity that are binding provisions, even where the term sheet or letter itself is non-binding.
- Break fee: Break fees are rarely used.
- Confidentiality: Most term sheets include provisions on confidentiality that are binding provisions, even where the term sheet or letter itself is non-binding.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Exclusivity agreements are rarely used because the letter of intent normally includes exclusivity provisions. Confidentiality and non-disclosure agreements are customary, and are either executed as a separate agreement or included as a provision in the letter of intent.

Is there a duty or obligation to negotiate in good faith?

There is a duty to act in good faith under Argentine law. The abusive exercise of rights is unlawful, being contrary to the purpose of the law and/or in excess of limits imposed by good faith, customs or morals. In principle, interrupting ongoing negotiations prior to execution of the transaction agreements will not normally give rise to such pre-contractual liability under that principle, as long as the interruption is not arbitrary or abrupt. However, the sudden or abrupt interruption of ongoing negotiations could fall under this rule if it could be considered as abusive and in violation of the good faith negotiations and confidence of the other party. In such a case, the party that ceased negotiations could be exposed to liability to compensate the other party for lost time and for the costs of any preparatory work undertaken in preparation for the abandoned deal.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: purchase price adjustments are fairly common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: all types are seen, including working capital adjustment, cash-free debt-free and NAV adjustments.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually prepared by the target company.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely.

Is an earn-out common?

Frequency/market practice: fairly common.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: fairly common.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common.

Is the MAE general or specific?

Frequency/market practice: both are seen.

Is the MAE quantified?

Frequency/market practice: fairly common.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: waterfall/blue pencil provisions are rare.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common.

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common.

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: fairly common.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: rarely.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality is generally quantified by a specific amount.

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: both types of knowledge qualifiers are seen, often limited to the actual knowledge and due enquiry of a specified list of senior management personnel.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common.

Is disclosure of the data room common?

Frequency/market practice: rarely.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common; repetition at completion is common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: yes. Usually the agreement establishes that warranties are made as of the signing date and as of the closing date.

Is a bring-down certificate at closing common?

Frequency/market practice: rarely; bring-down certificates at completion are not very common but are seen for certain transactions.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and correct.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: commonly less than 100%.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: entire agreement.

What are the common exceptions to the cap?

Frequency/market practice: key warranties and fundamental representations are often excepted (e.g., title, capitalization, authority). Often, tax and specific areas of concern are also excepted, sometimes with specific higher caps. Separate caps can be negotiated.

Is a deductible or basket common?

Frequency/market practice: fairly common.

Is a de minimis common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: a general survival of 18-36 months is common. Tax, labor and environmental liabilities are usually tied to expiry of the statute of limitations time period.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: rarely.

Is warranty insurance common?

Frequency/market practice: rarely.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: rarely.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: rarely.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: rarely.

Is there an exclusion of consequential damages?

Frequency/market practice: very common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: rarely.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: New York law or Argentine law.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: both are common. Place of arbitration depends on applicable law. Usually New York, but depends on the transaction. ICC and AAA are common.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: yes, it is usually shared 50%-50%. Stamp tax is between 1% and 2% of the economic value of the transaction depending on the local jurisdiction (Argentine province or City of Buenos Aires).

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: rarely.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Australia

Quick reference guide

Due diligence, pricing and closing

Due diligence issues: material contracts

In a share sale transaction, reviewing material contracts (shareholder agreements, customer contracts, banking contracts) for change of control provisions is key.

In asset sales, clauses relating to restrictions on the seller to assign their rights to the buyer are the most relevant.

Some contracts may require specialist competition law review, e.g., contracts between competitors, and a carefully managed due diligence process with "clean teams."

Signing/closing considerations

Is a deposit required?

The payment of deposits is not common practice in Australia except for the real estate sector. However, where a buyer is from an emerging market country and does not otherwise provide security, a non-refundable deposit of 10% is becoming more common to cover the seller's risk of not being able to force the buyer to complete the transaction.

Is simultaneous signing/closing common?

Simultaneous signing and closing is more commonly seen in straightforward deals with minimal conditions involving third parties. However, where it is necessary to obtain regulatory approvals or third-party approvals before closing (e.g., customer consents for change of control), then it is common for completion to occur within one to five business days from the satisfaction or waiver of the last condition precedent.

Pricing and payment

There are no requirements to carry out a valuation or follow a particular valuation model for determining the purchase price for companies or assets. In practice, commonly used valuation methods include net asset value and using a debt-free, cash-free basis valuation. The parties may also agree on an adjustment to the purchase price based on any shortfall or excess of the target's actual working capital against a target working capital. Net asset value adjustments are also common. There has been an increase in the use of 'locked-box' to reduce or eliminate the complexity of adjustments in recent years. There may be a requirement to carry out a valuation for stamp duty purposes.

Warranty and Indemnity insurance

In recent years, there has been an increase in the uptake of warranty and indemnity ("**W&I**") insurance by corporate and private equity parties in M&A transactions. There are two main types of W&I insurance: a buyer-side policy and a seller-side policy.

The most popular type of W&I insurance is the buyer-side policy, where the buyer is insured for any losses as a result of a breach of warranty (subject to the agreed limitations) given in the sale agreement.

The seller-side policy insures the seller for claims by the buyer with respect to financial loss arising from a breach of warranties given by the seller (subject to the agreed limitations). In the event of a breach of insured warranty, the buyer brings the claim under the sale agreement and the seller makes the claim against the insurance policy.

A W&I policy will usually cover warranties (e.g., title and capacity warranties, general business or operation warranties, and tax warranties) and general indemnities (e.g., tax indemnity covering unknown tax risks) provided under the sale agreement.

In the Australian market, average premium rates offered by insurers are currently below 1% of the insured limit for the first time since 2017.

Approvals/registrations

Foreign investment regulator

The Australian Government's Foreign Investment Review Board ("**FIRB**") is an advisory body to the Australian Commonwealth Treasurer in relation to investments (both direct and indirect) in Australia by 'foreign persons' and specifically whether or not those investments are consistent with the Australian national interest.

The Australian Commonwealth Treasurer has the ability to block certain acquisitions that it considers contrary to the Australian national interest.

Whether or not a FIRB 'no objection' letter (commonly referred to as 'FIRB approval') is required will depend on the identity of the acquirer (e.g., if the acquirer is classified as a 'foreign government investor'), the nature of the assets held by the target and whether or not the monetary threshold for FIRB approval is triggered. All monetary thresholds are temporarily AUD 0 following emergency COVID-19 related changes made by the Australian Government in March 2020. It is understood that these temporary changes will be wound back from 1 January 2021.

Ordinarily, for acquisitions by non-government investors of non-sensitive businesses in Australia, FIRB approval will be required if the total asset value or total issued securities value for the entities (whichever is higher) in Australia exceeds AUD 275 million (or AUD 1,192 million for investors from certain countries with which Australia has a free trade agreement). FIRB approval for an acquisition of shares is generally only required for acquisitions of 20% or more.

An AUD 0 threshold will apply if the buyer is considered a 'foreign government investor' and, from 1 January 2021, where investments are made in a new category of "sensitive national security businesses". Lower thresholds may also apply if the target holds significant land assets, or if certain types of land assets are being directly acquired.

Antitrust/competition approval

The Australian Competition and Consumer Commission ("**ACCC**") is the Australian antitrust regulator. In assessing mergers and acquisitions, its key focus is whether the transaction is likely to have the effect of substantially lessening competition in the relevant market.

While Australia has a voluntary merger filing regime, notification to the ACCC is usually recommended where, after the acquisition, the new entity will have a market share of 20% or more in the relevant market and the products of the parties are complements or substitutes. Relevant considerations include (1) what the 'relevant market' is and (2) the percentage of market share in the relevant market held by both the buyer and the target.

Corporate regulator

The Australian Securities and Investments Commission ("**ASIC**") is the Australian corporate regulator. ASIC does not directly regulate private asset or share transactions, but filings need to be lodged with ASIC within 28 days of a change in (i) share capital, (ii) ownership or ultimate ownership, (iii) address details or (iv) director and company secretary details of an Australian company. ASIC becomes more involved in takeover transactions involving Australian public listed entities.

Other regulatory or government approvals

Transactions involving certain sectors, such as healthcare, banking, renewables, insurance, financial services and broadcasting, may also involve regulators specific to the industry.

Employment

Share sale

In a share sale transaction, the legal entity being acquired continues to employ its staff after completion of the sale. The employment of the employees does not normally come to an end and the terms and conditions of employment do not change, subject to applicable change of control provisions (which are unusual in employment agreements).

Asset sale

In an asset sale, the employees will need to cease employment with the seller and commence employment with the buyer. The buyer will need to make an offer of employment to each employee. Generally, the terms and conditions of employment offered by the buyer need to be comparable or superior to the employees' existing terms and conditions to reduce the risk of the seller being liable for redundancy/termination costs. The offer should be conditional on completion occurring.

Employees cannot be forced to accept the buyer's offer. The seller will need to consider how to deal with employees who do not accept the offer and which party will bear any resulting costs.

Commercial issues to consider include redundancies, retention arrangements and indemnities for any claims made against the target company by employees.

Specialist employment law input is often engaged to review the terms of employment contracts, industrial awards and any rules of any employee share or option schemes or other employee benefit plans, and determine the consequences of the sale for participants in those plans.

Tax

Income tax

A non-resident is generally assessable to tax on income derived by it from Australian sources and on capital gains made on assets that are "taxable Australian property" ("**TAP**"). TAP may include Australian real property, business assets of Australian permanent establishments and non-portfolio interests in entities that hold a majority of assets that, by market value, comprise Australian real property. This position may be modified by the tax treaty in force between the relevant countries.

Foreign resident capital gains withholding tax

The buyer may be required to withhold 12.5% from the purchase price of certain classes of TAP and remit that amount to the Australian Taxation Office ("**ATO**") where the seller is a foreign resident. The asset sale or share sale agreement should be appropriately drafted to deal with this withholding tax.

Issues in a share sale

Under a share sale, the buyer assumes all the target entity's tax liabilities. The buyer should ensure that appropriate tax warranties and indemnities are included in the share purchase agreement to limit the buyer's exposure to such liabilities. Where the target entity is a subsidiary member of a consolidated group, the buyer should also confirm that a valid tax sharing agreement and tax funding agreement have been entered into, and that the share purchase agreement contains appropriate clear exit warranties and indemnities.

Consideration should be given to whether certain tax attributes of the target entity (e.g., tax losses) may be lost as a result of the share sale.

Issues in an asset sale

Under an asset sale, the seller retains all tax liabilities not specifically assumed by the buyer but needs to consider the tax implications of selling each asset. The seller may find it desirable to retain the corporate entity in order to utilize tax losses.

Transfer pricing issues

Where related parties are counterparties to the transaction and one of the entities is a non-resident, the transfer pricing rules should be considered. Generally, the conditions existing between the parties should be at arm's length.

Stamp duty

The rate of stamp duty and the categories of dutiable property vary between each Australian jurisdiction. The highest effective rates of duty range between 4.5% and 5.95%. Relevant to foreign purchasers, surcharge duty rates may also apply in respect of transactions concerning interests in residential land in certain States. Surcharge rates range between approximately 3% and 8% and surcharge duty is payable in addition to the primary duty.

The buyer is generally liable to pay stamp duty (under statute and contractually).

Share sale

A share sale may give rise to landholder duty if the company holds interests in land (directly or indirectly via downstream entities) with a total value reaching the threshold value relevant to the jurisdiction in which the interest is located. The threshold values range between AUD 0 to AUD 2 million. Landholder duty can arise even if the transaction is between foreign entities and the target is a foreign entity.

Duty is calculated by applying the relevant rate to the market value of the landholdings (plus goods in some jurisdictions). For freehold interests in land, an independent valuation report may be required.

Asset sale

An asset sale may be dutiable, depending on the nature of the assets and location. Most dealings in real estate (excluding certain kinds of leasehold interests) will be liable to duty in all States and Territories. A sale of intangible business assets (e.g., goodwill or IP) may result in a stamp duty liability in certain jurisdictions only.

Duty is calculated by applying the relevant rate to the higher of the market value of the dutiable property or the consideration provided (on a GST inclusive basis). Whether or not GST is payable will therefore affect the duty outcome.

Goods and services tax ("**GST**")

Share sale

No GST should be payable by the seller on a sale of shares. The seller and buyer may not be able to recover full input tax credits for GST paid on acquisitions that relate to the sale or acquisition of the shares (resulting in 'GST leakage'). They may be able to claim a 75% or 55% reduced input tax credit for GST paid on certain acquisitions (e.g., certain securities transactions services).

Asset sale

An asset sale will likely be subject to GST at a rate of 10%, unless there are input-taxed or GST-free components (e.g., farm land). A sale of a business may qualify as a GST-free supply of a going concern if certain statutory requirements are satisfied.

A sale contract should contain a clause that allows the seller to 'gross up' the purchase price and recover the relevant GST amount from the buyer.

Post-acquisition integration

It is often not possible to transfer all of the shared support services on completion and some will need to continue being provided by the seller on a transitional basis for a period after completion. The extent of these services will depend on the particular buyer's needs, and the nature of the business will vary between different bidders.

In that case, it is likely that the parties will need to negotiate a transitional services agreement to be signed with effect from completion.

It is in the buyer's interest to consider the list of possible transitional services they would require during the transitional period. The seller should consider whether to provide these services during the transitional period, and if so, for how long.

Another issue to consider is that shared support services are often dependent on contracts with third-party service providers. Third-party contracts can increase the complexity involved in continuing shared support services post-completion, particularly if they have restrictions on the parties who can benefit from the services. There are generally restrictions in place on assignment of the benefit of the contracts without the third party's consent.

Stamp duty exemptions may be available for transfers of shares or assets within corporate groups to facilitate a post-acquisition integration. Transactions between members of the same tax consolidated group (or MEC group) and the same GST group should be disregarded for income tax and GST purposes respectively.

Common deal structures

What are the key private M&A deal structures?

The sale and purchase of private companies usually takes the form of either an asset acquisition, when the assets of a business are purchased and certain liabilities assumed, or a share acquisition. A share acquisition may proceed by way of direct share acquisition, which is the purchase of shares in an Australian company; or indirect share acquisition, which is the purchase of shares in a non-Australian corporation that holds the shares of the Australian company.

Auction bid processes are an alternative to negotiating bilateral contracts, which are the traditional structure used to acquire an Australian company. Competitive auctions are being used in about half of the deals that Baker McKenzie is involved in compared with private sales.

A procedure known as a 'scheme of arrangement' is also available in Australia under which two companies may merge, subject to the approval of a State Supreme Court or federal court and the target's shareholders in a general meeting. Schemes of arrangement are rarely used in a typical private M&A transaction and are more common in a public M&A or public-to-private transaction.

Business acquisitions in Australia are more commonly in the form of either an asset acquisition or a share acquisition. An acquisition of shares is a straightforward process. The main disadvantage compared to an asset sale is that the acquisition of shares of the target company involves the purchase of the target company together with all liabilities (including contingent or undisclosed liabilities such as undisclosed tax liabilities, breaches of legislation affecting the business or claims by customers or employees), which may have an impact on the value of the shares being acquired. There is no concept of merger in Australia.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

Private companies must be either limited by shares or established as unlimited companies with share capital.

What are the different types of limited liability companies?

There are limited and unlimited companies. In the case of limited companies, the liability of shareholders is usually limited to the amount of their capital contribution in the company; in the case of an unlimited company, the personal liability of the members for the debts and obligations of the company is unlimited.

Is there a restriction on shareholder numbers?

A proprietary company cannot have more than 50 non-employee shareholders and must have at least one director who is ordinarily resident in Australia. Shares in a private company may not be offered to the public.

What are the key features of a share sale and purchase?

An acquisition of shares is often simpler than an acquisition of assets as it is (generally) only necessary to transfer the shares in the target company, which is a straightforward process in Australia. The acquisition of shares of the target company involves the purchase of the target company together with all liabilities (including contingent or undisclosed liabilities such as undisclosed tax liabilities, breaches of legislation affecting the business or claims by customers or employees), which may have an impact on the value of the shares being acquired.

What are the key features of an asset sale and purchase?

In an asset acquisition, it is necessary to separately deal with and transfer or assign each asset and assumed liability in accordance with the contractual, legislative or other requirements governing that particular asset or liability. The seller may more easily select which assets it wishes to divest under an asset sale than under a share sale. The seller may also wish to retain the corporate entity in order to utilize tax losses, which it cannot do under a share sale.

An asset acquisition is therefore often more logistically complex and time consuming than a share purchase.

In contrast to a share acquisition, under an asset purchase the seller retains all liabilities not specifically assumed by the buyer.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

It is not unusual for negotiated acquisitions to begin with (or include) the negotiation of a letter of intent ("**LOI**"), which can also be known as a memorandum of understanding ("**MOU**") or heads of agreement ("**HOA**"). The LOI is a useful outline of the transaction and may also serve to (among other things):

- prevent a seller from negotiating with other parties;
- allow relevant governmental approval processes to begin;
- facilitate fundraising for the transaction;
- define a buyer's inspection and due diligence rights;
- provide for the treatment of confidential and proprietary information; and
- establish a schedule for completing all matters necessary to close the transaction.

The LOI may be expressed to be binding or non-binding, either wholly or in part. Unless drafted carefully, a court may decide that the document is non-binding, even if it states that it is intended to be binding.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: It is common to include binding exclusivity provisions in the letter of intent or term sheet, even if the entire letter itself is not binding.
- Break fee: Break fees are not particularly common in private M&A transactions. However, if they are seen, it would be for larger or competitive bid transactions. Break fees are more commonly used for public M&A transactions.
- Confidentiality: It is common to include binding confidentiality provisions in the letter of intent or term sheet, even if the entire letter itself is not binding.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Confidentiality letters and agreements are commonly entered into, particularly where the seller is providing the buyer with due diligence information. Exclusivity agreements are also commonly entered into and exclusivity provisions are often included in confidentiality agreements as well as letters of intent.

Is there a duty or obligation to negotiate in good faith?

In Australia, there is no general obligation to act in good faith. There is some uncertainty under Australian contract law about the circumstances in which an obligation to use good faith when entering and performing a contract will be implied. For example, several cases have held there to be an implied obligation to use good faith when exercising a right to terminate for breach. However, it is not settled under Australian law that an obligation to use good faith when entering and performing a contract will always be implied. The most common remedy is financial damages to compensate a party for its loss and put it in a position as if the contract had been performed. Damages are the most commonly pursued remedy and may be awarded by a court or any other adjudicator.

Agreeing to the acquisition agreement

Purpose price

Is a purchase price adjustment common?

Frequency/market practice: purchase price adjustments are common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: cash-free, debt-free and working capital adjustments are typical. NAV adjustments are also common. Recently, there has been some use of locked-box mechanisms to reduce or eliminate the complexity of the adjustments process.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely; collars are not common. Sometimes, a *de minimis* is agreed.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually prepared by the target company (i.e., buyer-controlled). This is a matter for negotiation. It is considered an advantage to prepare the first draft.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely.

Is an earn-out common?

Frequency/market practice: rarely; we are seeing more earn-outs to bridge the gap between forecast earnings views/valuations of seller and buyer. If used, earn-outs are commonly capped.

Is a deposit common?

Frequency/market practice: rarely; although this is becoming slightly more common.

Is an escrow common?

Frequency/market practice: fairly common.

Is a break fee common?

Frequency/market practice: rarely used, although we are seeing some in private deals, at approximately 1% (which is similar to public companies rules).

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: rarely; becoming increasingly popular, particularly in light of COVID-19 and where there is a long period between execution and completion. It is also more common where a foreign seller or buyer is involved.

Is the MAE general or specific?

Frequency/market practice: both are seen; often combined.

Is the MAE quantified?

Frequency/market practice: rarely; we tend to encourage clients to be more specific. It is often combined with a general MAE.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common, depending on the nature of the buyer and seller.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: waterfall/blue pencil provisions are fairly common, as courts will sometimes read down the period/geographical reach.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common (in conjunction with a non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common; it is customary to include restrictions on the seller in relation to the conduct of the target's business in the period between signing of the purchase agreement and completion so that, for example, there are no amendments to the constitution and no entry into transactions with a value above a specified amount without the consent of the buyer.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; this is generally used in private deals.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: updating disclosure is rarely permitted after execution. Notification of possible breach is fairly common. In the case of a material breach, sometimes there is a right to terminate but more commonly there is only an indemnification/damages claim.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen but are often not quantified, so, for example, knowledge qualifiers are common (other than specific warranties, e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are common, but only appropriate for certain warranties. They are often limited to the actual knowledge and due enquiry of a specified list of senior management.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: very common; this is always requested by buyers, but typically one of the most contested warranties.

Is disclosure of the data room common?

Frequency/market practice: this is very common as it is standard practice. It is fairly common for the buyer to seek to limit disclosure to matters fairly disclosed with sufficient particularity to enable the buyer to assess the impact of the disclosed matter on the target company/business.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: repetition at completion is very common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: common in buyer-friendly agreements.

Is a bring-down certificate at closing common?

Frequency/market practice: rarely; bring-down certificates are not very common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and correct and (if acting for buyer) not materially misleading.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely; double materiality is usually avoided.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: the cap is often split between title, tax and other material warranties (100%) and other more general warranties (lower percentage cap, anywhere between 10% (auction deal) to 50%). Big deals will tend to have a lower aggregate cap.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: both are seen regularly.

What are the common exceptions to the cap?

Frequency/market practice: key warranties are often exempted from the lower cap, but still subject to a 100% cap (e.g., title, capitalization, authority, tax and sometimes some specific areas of concern).

There is usually a carve-out from all limitations (including cap) for fraud and deliberate non-disclosure.

Is a deductible or basket common?

Frequency/market practice: basket is more common, but both are seen.

Is a de minimis common?

Frequency/market practice: very common.

How long does seller liability survive?

Frequency/market practice: it is common to have 18-24 months for general warranties. It is generally longer (about 4-5 years) for title, capitalization, authority and tax warranties.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: key warranties are often exempted from the lower cap, but still subject to a 100% cap (e.g., title, capitalization, authority, tax and sometimes some specific areas of concern). There is usually a carve-out from all limitations (including cap) for fraud and deliberate non-disclosure.

Is warranty insurance common?

Frequency/market practice: fairly common; W&I insurance is becomingly increasingly common.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: uncommon.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common for actually received.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common for actually received.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: very common; this is required by law for a contractual claim for damages, but failure to mitigate is still usually an express limitation on liability to the extent that loss increased as a result.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common. The definition of consequential loss is a matter for negotiation.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: very common; sellers and buyers will negotiate for these respective positions.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: usually, an Australian state law is chosen.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: litigation is more common, but arbitration is becoming more common where parties are from different jurisdictions.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: stamp duty is not payable on share transfers (provided that the target company does not hold significant land assets and is not landholder). Stamp duty on asset transfers is usually borne by the buyer (at law in most Australian States/Territories) and it is highly unusual for parties to agree otherwise. The rate varies between asset types and from state to state.

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: it is very common to have a specific tax indemnity, usually included in the purchase agreement.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Austria

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

The focus of the legal due diligence will strongly depend on the target company's business. It is therefore advisable to precisely determine the target company's business in a first step, to ensure an efficient legal due diligence review.

In the vast majority of cases, the following issues are typically considered in a legal due diligence: corporate matters (e.g., issues in connection with evidencing a proper share history of the target company), commercial contracts (e.g., change of control or exclusivity provisions), financing/loan agreements (e.g. change of control provisions), real estate (e.g., lease agreements), employment and pension matters, regulatory/public law matters (e.g., repayment of granted funds), litigation (e.g., pending lawsuits) and IP/IT matters.

While vendor due diligence reports or legal fact books are typically not conducted in Austria, they are becoming more common in auction processes involving larger target companies.

Payment

Austrian purchase agreements commonly provide for escrows but not for deposits.

Acquisition methods

Austrian businesses are mostly acquired by means of a share deal. For the acquisition of smaller businesses, and in particular, in distressed situations (that is, where the relevant company faces financial adversity), buyers also choose to undertake asset deals. The choice of the transfer method will depend substantially on a number of considerations, in particular, tax implications, the scope and complexity of the target business, and liability risks connected with the acquisition.

Share sale

The acquisition of a corporation by means of a share deal may be effected by purchasing all or part of the shares of a company, or by increasing its share capital and subscribing to new shares. In share deals, the legal entity of the target company remains unchanged and, in principle, agreements entered into by that company and the respective parties also remain unchanged. The buyer of a share is usually not liable for the debts of the target company; but if the share capital is not fully paid-up or has been repaid, the buyer may be liable to pay up the remainder. For buyers of shares in an Austrian limited liability company (*Gesellschaft mit beschränkter Haftung* – "**GmbH**"), this would even include liability for the remainder of other shareholders.

Transfers of title to shares

An Austrian notarial deed is required for the transfer of shares in a GmbH. The articles of association may subject the transfer to additional conditions (which would also have effect *vis-à-vis* third-party acquirers), such as prior consent requirements or pre-emptive rights of other shareholders. The GmbH must be notified of the transfer to allow the new shareholders to exercise their rights against the company.

For Austrian stock corporations (*Aktiengesellschaft* – "**AG**"), in principle, no specific form requirements apply to the transfer of shares. Shares in non-listed companies must be issued in the form of registered shares. Registered shares are transferred by means of written endorsement by the seller. The company must be notified of the transfer of registered shares. The articles of association of a company may impose additional shareholder consent requirements for registered shares, but due to the principle of free disposal of shares, the Austrian Stock Corporation Act (*Aktiengesetz* – "**AktG**") does not provide for the possibility of pre-emptive rights for other shareholders or third parties in the articles of association. However, a shareholders' agreement may provide for pre-emptive rights.

Asset sale

In an asset deal, all or part of the assets of a going concern are acquired. There is no comprehensive code in Austrian corporate and civil law relating to acquisitions of a business as a going concern. In principle, each single asset must be transferred in compliance with the transfer and form requirements for that particular asset. Despite the need to transfer each asset separately (with some exemptions), asset deals can be attractive to buyers for tax reasons and also because of the opportunities to carve out only certain parts of a legal entity.

Transfers of title to assets

Austrian corporate and civil law does not contain any comprehensive set of provisions relating to the acquisition of a business as a going concern. In principle, each single asset must be transferred in compliance with the transfer and form requirements for each asset (for exemptions, see below). As such:

- property rights must be transferred according to applicable property law provisions (e.g., transfer of real estate must be recorded in the real estate register);
- claims need to be transferred by means of an assignment, which is subject to notification requirements;
- tangible assets are transferred by physical delivery, if physical delivery is not possible or only possible with unreasonable effort a symbolic delivery will suffice;
- intangible property rights must be entered into the relevant public registers according to applicable intellectual property laws.

Generally speaking, the rights of a contractual party can be transferred only by assumption of contractual rights, with the approval of all other contractual parties. However, the Austrian Commercial Code (*Unternehmensgesetzbuch* - "**UGB**") facilitates this requirement by adopting a legal presumption of approval by the contractual parties (see Section 38 UGB).

Some contracts/rights will transfer automatically by operation of law to the new owner (e.g., employment contracts, some insurance contracts and certain tenancy rights). A shareholders' resolution is required to approve the transfer by a GmbH or an AG of all its assets. The resolution in these two cases will require approval by a majority of at least three-quarters of the nominal capital represented or by a greater quorum if required by the articles of association. This approval requirement also applies where a substantial part of the company's business is to be transferred (according to legal academics).

Approvals/registrations

Foreign investment

Austria introduced foreign investment control in 2011. The legal basis for foreign investment screening is laid down in the Foreign Trade Act 2011 (*Außenwirtschaftsgesetz 2011* - "**AußWG**").

In May 2019, the Austrian government published a draft bill amending the current rules on foreign direct investments ("**FDI**") and step up control of foreign investments. The proposal - which foresees a number of changes - is currently pending.

Under the current rules, acquisitions of 25% or more of a controlling interest by a non-EU, non-EEA and non-Swiss person in an Austrian enterprise engaged in a particular protected industry sector defined under the AußWG must seek the prior approval of the Federal Ministry Republic of Austria - Digital and Economic Affairs (*Bundesministerium für Digitalisierung und Wirtschaftsstandort* - "**BMDW**"). Protected sectors include the defense equipment industry, security services, energy supply, water supply, telecommunication, traffic, and infrastructure in the healthcare and educational sector.

The application for approval by the Ministry must be submitted before entering into a legally binding agreement to acquire the relevant interest or before announcing the launch of a public offer in an enterprise of the protected sector. Additionally, the AußWG provides for an *ex officio* review procedure. The waiting time for the approval is between one and three months from the application.

Any prohibition will have to be reasoned and is subject to appeal. The sanctions for violation of the approval requirement include the invalidity of the acquisition agreement. Additionally, even negligent violations of the approval requirements are subject to fines.

Merger control

The Austrian Cartel Act 2005, as amended, contains the Austrian merger control provisions. The Federal Competition Authority (*Bundeswettbewerbsbehörde* – "**BWB**") is the regulator. Its main function is to investigate and detect activities that could potentially have the effect of restricting competition. Merger notifications (four copies of which) must be filed with the BWB. The Cartel Court and the Cartel Court of Appeals are the "decision-making courts", which can order remedies to diminish anti-competitive effects.

Austrian merger control provisions prohibit the completion of a notifiable transaction prior to the transaction being cleared by the authorities (BWB and Federal Cartel Prosecutor).

Employment

General

In share acquisitions, the employment conditions of the employees of the target company remain unchanged since the employer remains the same entity.

An asset acquisition will likely qualify as a transfer of business pursuant to Austrian TUPE rules. Where a transfer of business takes place, the affected employees are transferred automatically by operation of law to the buyer, which becomes the new employer. Generally, the employees transfer with all existing rights and obligations.

Transfer of business

Employers must inform the works council (where there is one) of any proposed transfer of business prior to the transfer.

If no works council exists, the transferor or transferee must inform affected employees in writing before the transfer. That information must include the date of transfer, the reasons for the transfer, as well as legal, economic and social consequences of the transfer for the employees, and any measures that may be taken as a result of the transfer.

Mergers also qualify as a transfer of business, triggering notification and/or consultation requirements.

Approval or consultation requirements

In the course of corporate restructuring, the works council obtains further participation rights. Hence, employers must inform the works council (where there is one) of potential operational changes to the business. Examples of operational changes (see Section 109(1), Labour Constitution Act (*Arbeitsverfassungsgesetz* – "**ArbVG**")) include inter alia the downsizing or closure of a business or parts of the business or merger with other companies. Such information has to be provided vis-à-vis the works council in a timely and effective manner which enables it to evaluate possible effects and conduct meaningful consultation before such changes become implemented. If certain conditions are met, the works council may also enforce social plans mitigating detrimental effects to workforce.

Tax

Acquisition of shares

Following the abolishment of capital transfer tax (*Gesellschaftsteuer*) on 1 January 2016, equity contributions of a direct shareholder in its Austrian subsidiary are no longer taxable.

Acquisition of assets

The transfer of real estate generally triggers real estate transfer tax ("**RETT**") of 3.5% of the purchase price of any property located in Austria. Registration fees add on at least an additional 1.1%.

RETT, in the amount of 0.5%, may also apply to a share deal if 95% or more of the shares in a domestic entity owning real estate is acquired: (i) by one buyer; or (ii) by members of the same tax group (within the meaning of Section 9 of the Austrian Corporate Income Tax Act (*Körperschaftsteuergesetz*)). In this event, RETT may be avoided by transferring a minor share (more than 5%) in the Austrian subsidiary to a second shareholder.

Austria also imposes stamp duty on various legal transactions, such as assignments of receivables (0.8%) or lease agreements (1%) - whereas lease agreements concerning living space concluded as of November 11, 2017 are no longer subject to stamp duty. In practice, these fees can be avoided by undertaking appropriate structuring.

Mergers

Under certain conditions, a merger is exempt from capital transfer tax and VAT, and the rate of RETT can be lowered.

VAT

There is no exemption from VAT for the transfer of a going concern, so asset acquisitions are subject to VAT at statutory rates (i.e., 10%, 13% or 20%, depending on the relevant good or service), unless assets that are exempt from VAT (i.e., receivables) are transferred. Austria levies VAT on domestic supplies and services at a rate of 20%. Reduced rates of 10% or 13% may apply to certain supplies; specially enumerated services and supplies (such as hospital services rendered by public corporations) are exempt from tax. Export of goods is zero-rated and intra-community supplies are exempt from Austrian VAT, but intra-community acquisitions trigger VAT at the statutory rates. Intragroup services supplied within a domestic group are disregarded for VAT purposes.

Share sales are usually exempt from VAT.

Post-acquisition integration

N/A

Common deal structures

What are the key private M&A deal structures?

The sale and purchase of private companies usually takes place by means of a share deal where the legal entity of the target company remains unchanged and thus, in principle, agreements entered into by that company and the respective parties also remain unchanged. The buyer of a share is usually not liable for debts of the target company; but if the share capital is not fully paid-up or has been repaid, the buyer may be liable for settling the remainder (for buyers of shares in a GmbH, this would even include liability for the rest of the other shareholders).

In instances of smaller businesses and in distressed situations in particular, buyers also choose to undertake asset deals where all or part of the assets of a going concern are acquired. There is no comprehensive code in Austrian corporate and civil law relating to acquisitions of a business as a going concern, but in principle, each single asset must be transferred in compliance with the respective transfer and form requirements for that particular asset.

The legal framework applicable to a transaction will differ, depending on the type of company involved and whether the transaction is structured as a purchase of shares or a purchase of assets. The choice of the transfer method will depend substantially on a number of considerations, in particular: tax implications, the scope and complexity of the target business, and liability risks connected with the acquisition.

In recent years, it has been increasingly popular for buyouts of a private company to take place following an auction process, where several competing bidders are invited by the seller to bid for the target company and where the seller ordinarily concludes a sale and purchase agreement with the bidder that offers the highest price and the most favorable contractual terms. Further, auction processes are common in Austria for stakes in larger businesses. Bid process letters are frequently used, whereas both non-binding indicative bid letters and binding letters at the final offer stage are seen.

Two basic structures of mergers can be distinguished. Either the target company is merged into an existing company, with the shareholders of the target company receiving shares in the surviving company as compensation (absorption); or a new company ("**NewCo**") is formed, to which all the assets and liabilities of two or more companies are transferred, with the shareholders of both/all companies receiving shares in NewCo (consolidation). In both cases, the target companies are dissolved by operation of law. Austrian corporate law allows mergers between two or more GmbHs and two or more AGs. Mergers of GmbHs with AGs are also possible.

Mergers are mainly used for internal reorganizations within groups rather than for acquisitions of an unrelated business.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

The predominant forms of legal entities used for doing business in Austria are the GmbH and the AG. The number of GmbHs has recently exceeded 100,000, with AGs at around 1,300. Another legal form for doing business in Austria is the European Company (*Societas Europaea* — "**SE**").

What are the different types of limited liability companies?

Austrian company law provides for three types of companies with limited liability: GmbHs, AGs and SEs.

A GmbH is the most frequently used business organization in Austria, and it is governed by the Austrian Limited Liability Companies Act (*Gesetz über Gesellschaften mit beschränkter Haftung* – "**GmbHG**"). GmbHs are required to have at least one director, which may not be a legal entity.

A GmbH may be established and owned by a single shareholder, including multiple layer structures of sole shareholding. There are no requirements for the shareholders to be Austrian nationals. Shares in a GmbH may not be publicly traded. Shareholders must be registered with the company's register, but registration is declaratory in nature, so it is not a required prerequisite to a share transfer.

The GmbH's general assembly is deemed to be the supreme body of the company, in particular enjoying an extensive instruction right vis-à-vis the company's management.

AGs are governed by the provisions of the AktG. As with the GmbH, in principle, the shareholders of an AG may not be held liable for liabilities of the company. One main difference with the GmbH relates to the focus of the AG: whereas a GmbH is designed as a legal entity for a few individuals (usually involved in the company's management), an AG is designed to attract a large number of investors who are not personally involved in the management of the company. Accordingly, shares in an AG may be publicly traded. However, in practice, only about 100 out of approximately 2,000 AGs are listed on a stock exchange. In recent years, the legislator has also begun to differentiate between listed and non-listed AGs in various legal reforms. AGs must have managing directors and a supervisory board, which are independent from, and not subject to, shareholders' instructions.

Is there a restriction on shareholder numbers?

Under Austrian law, there is no restriction on the number of shareholders.

What are the key features of a share sale and purchase?

In a share deal, the legal entity of the target company remains unchanged and therefore, in principle, agreements entered into by that company and respective parties also remain unchanged. The buyer is not usually liable for the debts of the target; however, if the share capital is not fully paid up or has been repaid, the buyer may be liable to pay up the remainder.

What are the key features of an asset sale and purchase?

In an asset deal, all or part of the assets of a going concern are acquired. Austria currently has no comprehensive code in relation to the acquisition of a business as a going concern. However, in principle, each single asset must be transferred in compliance with the respective transfer and form requirement for that particular asset. Asset transfers are appealing to the buyer for tax reasons and due to the opportunity to limit the buyer's risks. Further, the buyer can choose whether to acquire all or only certain assets.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

Negotiations usually begin with the circulation of a letter of intent or term sheet. Usually, letters of intent/term sheets are non-binding for both parties, but may include an (binding) exclusivity clause. Confidentiality obligations are usually binding.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: Exclusivity provisions are usually included in term sheets and letters of intent.
- Break fee: Break fees are increasingly being seen, particularly during an auction process.
- Confidentiality: Confidentiality provisions are usually included in term sheets and letters of intent.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Separately negotiated confidentiality or non-disclosure agreements are almost always drafted as a first step in a potential transaction. Depending on the transaction setup it is also common to include exclusivity agreements. Break fees (if any) are usually not supplemented with separately negotiated agreements.

Is there a duty or obligation to negotiate in good faith?

Basically, under Austrian law, the parties are free to abstain from concluding a contract at any point until they have reached full consensus on all issues still outstanding; that is, until one party has fully accepted the other party's offer. Until such full consensus has been reached, in principle, no party should assume that a contract will, in the end, be concluded, and therefore each party generally acts at its own risk. This principle is, however, modified by the general duty to act in good faith. Legal academics and Austrian courts therefore provide that as soon as the parties enter into contractual negotiations, there is a pre-contractual duty to safeguard the other party's interests. Neither party may mislead the other concerning its own willingness and honesty to conclude the contract, especially if one party is aware that the other party is incurring expense in leading to the conclusion of the contract, but knows it is not itself willing to close the deal (for whatever reason).

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: very common, especially in a share sale.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: purchase price adjustments are usually based on a cash-free/debt-free mechanism (usually combined with (minimum) working capital adjustments or equity adjustments).

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: the buyer usually does, whereas measures protecting seller's interests (e.g., inspection and objection rights/consultation obligations) are implemented.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely; however, a review by auditors is common.

Is an earn-out common?

Frequency/market practice: rarely; although IP/IT related acquisitions tend to include earn-out provisions more frequently.

Is a deposit common?

Frequency/market practice: rarely, no.

Is an escrow common?

Frequency/market practice: fairly common; a portion of the purchase price may either be withheld or placed in an escrow account for a fixed period as security for the payment of any claims under the representations and warranties to meet any warranty or indemnity claims. In recent years, insurance covering damages resulting from breach of warranties and indemnities has become a part of transactions in Austria.

Is a break fee common?

Frequency/market practice: rarely, no.

Conditions precedent

Frequency/market practice: fairly common; besides merger control clearance, which regularly has to be covered by conditions precedent, the agreement may also be subject to the obtaining of certain (legally required) approvals (e.g., by authorities or shareholders) or non-occurrence of certain material adverse changes.

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: rarely.

Is the MAE general or specific?

Frequency/market practice: this will depend on the negotiations, whereas in the current market environment sellers only accept specific MAE clauses.

Is the MAE quantified?

Frequency/market practice: very common; if MAE accepted, it is very common to quantify such events.

Covenants

Frequency/market practice: fairly common; to the extent permissible under applicable antitrust law.

Is a non-compete common?

Frequency/market practice: very common; a non-compete is very common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: rarely; waterfall provisions are rarely used.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common; these are fairly common (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common; these are fairly common (in conjunction with a non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: fairly common; these are fairly common to the extent permissible under applicable antitrust laws.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; generally, there is (to the extent permissible under applicable antitrust laws) broad access.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: fairly common; common to update only such schedules that were not available at signing (e.g., contracts). Notification of possible breach has been seen. Breach might lead to the right to terminate (usually depending on the seriousness of the infringement).

Representations and warranties

Frequency/market practice: very common; SPAs usually provide for a contractual liability regime of its own kind. However, in case of distressed transactions, representations and warranties will be limited.

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; this is often not quantified, but defined in an abstract manner. In addition, *de minimis* amounts are agreed upon.

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice : this is often limited to actual knowledge and to due and careful inquiry with key persons (e.g., managing directors).

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common; yes.

Is disclosure of the data room common?

Frequency/market practice: fairly common; yes, although certain limitations may apply (e.g., only such facts are deemed disclosed as can be derived; (i) using the efforts and having the knowledge of a common buyer; or (ii) from an individual document included in the data room (i.e., without having to read various documents and combine the information contained therein)).

Repetition of representations and warranties

Frequency/market practice: this is fairly common with respect to key warranties (title, no insolvency or others, depending on the business of the target).

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common; both repetition at completion and at all times between the signing and completion were seen. Bring-down certificates are rarely seen.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: fairly common; both repetition at completion and at all times between signing and completion have been seen. Bring-down certificates are rarely seen.

Is a bring-down certificate at closing common?

Frequency/market practice: rarely; bring-down certificates are rarely seen.

What is the applicable repetition standard e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: the general standard is true and accurate, whereas qualification (true and accurate in all material aspects) may apply.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: no, this is rarely used.

Limitations on liability

Frequency/market practice: very common; both limitations on the amount of liability (caps, baskets, de minimis) as well as time limitations are very common.

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: usually 100% as to title (and potentially tax) and between 5% and 35% in respect of other liabilities.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: this usually applies to warranties only.

What are the common exceptions to the cap?

Frequency/market practice: title and tax (in which case 100% cap applies) and certain covenants (e.g., non-compete).

Is a deductible or basket common?

Frequency/market practice: fairly common; a basket is more common.

Is a de minimis common?

Frequency/market practice: very common; yes, this is basically seen in every transaction (however, potentially not applicable to tax warranties).

How long does seller liability survive?

Frequency/market practice: usually between one and three years. Exceptions for fraud, tax, environmental and title warranties are common.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: exceptions for fraud, tax, environmental and title warranties are common.

Is warranty insurance common?

Frequency/market practice: this is rarely used in Austria, but increasingly seen.

Set-offs against claims

Frequency/market practice: rarely; other than a set-off against claims for tax benefits, the right to set-off is usually excluded.

Is a set-off against claims for tax benefits common?

Frequency/market practice: this is very common.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: this is fairly common for amounts actually received (or amounts that could have been received).

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: it is fairly common for amounts actually received (or amounts that could have been received).

Damages, knowledge

Frequency/market practice: fairly common.

Analysis: limitation of liability for matters are fairly disclosed.

Is there an obligation to mitigate damages?

Frequency/market practice: an obligation to mitigate damages is required by law (and contractually specified).

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: fairly common (exclusions relating to tax may apply).

Dispute resolution

Frequency/market practice: very common; we see a trend showing that arbitration is becoming less popular, also in cross-border transactions.

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: Austrian law.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: fairly common; international investors still tend to prefer arbitration, despite arbitration becoming less common. Common places of arbitration include Vienna, Zurich, Paris and London.

Stamp duty and tax

Frequency/market practice: very common; usually costs, including fees, expenses and charges, are borne by the party having commissioned such costs. Stamp duty is usually borne by the buyer. Costs for notarization of the transfer agreement (if any) are usually borne by the buyer.

If stamp duty is payable, is it normally shared?

Frequency/market practice: this is usually paid by the buyer.

Is a separate tax covenant / indemnity or tax deed common?

Frequency/market practice: very common; yes, this can be seen in almost every transaction.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Belgium

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

In Belgium, it is customary to finalize the due diligence before execution of the acquisition agreement. There are no particular issues that a foreign investor should be aware of when undertaking a due diligence review of a Belgian entity or group of assets, other than those usually reviewed. The main areas of review in the due diligence process vary from project to project, but generally include corporate, commercial, employment, real estate, regulatory and tax matters. Based on the due diligence findings, the parties may negotiate special closing conditions and specific indemnities, and tailor specific representations and warranties. In addition an escrow account to deposit part of the purchase price to guarantee the seller's indemnification obligations may be opened, or the purchase price may be reduced.

Pricing

The "locked box" mechanism has become a common mechanism for determining the purchase price for share deals in Belgium. Closing accounts mechanisms are, however, still used from time to time. Earn-outs are also sometimes seen. Following the COVID-19 pandemic, closing accounts and earn-out mechanism may become more prominent.

Payment

Wire transfers of funds, including through the SWIFT Code international system, are common.

Signing/closing

Pre-contractual obligations

Under Belgian law, parties negotiating a transaction, including a sale and purchase of shares, assets or a business, are under a general obligation to conduct the negotiations in good faith. This entails, among other things, that negotiations which are at a reasonably advanced stage where a party can reasonably expect that a transaction will occur, in principle cannot be terminated unilaterally without due and reasonable justification. Where there is a breach of pre-contractual obligations, the party in breach, and potentially even its representatives, can be held liable for damages.

Simultaneous signing and closing/conditions precedent

In small deals, and otherwise where possible, simultaneous signing and closing is common. Whether signing and closing is simultaneous or non-simultaneous will depend on whether there are conditions precedent that must be satisfied, including regulatory approvals (e.g., merger control), divestments or spin-offs of certain parts of the target entity, third-party consents or waivers, or the resolution of issues discovered during due diligence.

Approvals/registrations

Foreign investment

Belgium has no exchange controls which have any substantial impact on mergers and acquisitions. At the date of this publication, there are also no foreign investment approvals of general application.

Historically, there was a law of 30 December 1970 with respect to economic expansion prescribing certain notifications to certain authorities in case of a sale of an enterprise with activities on the Belgian territory (if certain conditions were met). The law has however been abolished for the Flemish Region and the Walloon Region. It has also been abolished for the Brussels Capital Region, but for this Region the entry into force of the abolishment has never been determined. Hence for this Region this law would still be applicable. There was a time when for any qualifying M&A transaction these notifications would be sent prior to completion of the transaction, even though non-compliance with the notification requirement was not subject to any sanction. But as at today such practice no longer exists. In addition, not notifying still does not lead to any sanction whatsoever, which is also the reason why these notifications are often no longer done.

On 5 December 2018, the Flemish Parliament approved a proposal of Flemish Decree providing for a veto right for the Flemish Government in case of foreign investment in certain strategic sectors in Flanders. The Decree sets out that legal actions involving certain public or semi-public entities resulting in foreign persons acquiring control over such instances can be declared null and void or inapplicable by the Flemish Government if such acquisition poses a threat to the strategic interests of the Flemish Community or Flemish Region. Also certain other entities may be subject to the aforementioned screening procedure to the extent these have legal personality, have been established specifically for catering to one or more needs of general interest, and either (a) such entity is financed for more than half of their financing needs by an entity in the scope of the Decree, (b) an entity in the scope of the Decree has more than half of the votes at the governing body of such entity, or (c) such entity is supervised by an entity in the scope of the Decree.

Merger control

An acquisition involving a Belgian target company or a target company with sales in Belgium can be subject to either Belgian merger control regulation or the European Union merger control legal framework. If an acquisition is subject to EC merger control, it will fall outside the remit of Belgian merger control. Under the Belgian merger control rules, pre-completion notification is compulsory if the following thresholds are met:

- the combined aggregate turnover in Belgium of the undertakings concerned exceeds EUR 100 million; and
- each of at least two of the undertakings concerned generates an aggregate turnover in Belgium of at least EUR 40 million.

If the thresholds are met, the Belgian Competition Authority ("**BCA**") will evaluate the acquisition. The BCA will prohibit any concentration if it finds that the acquisition would significantly impede effective competition in the Belgian market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, unless it finds that the concentration produces economic benefits that outweigh the distortion of competition. In balancing these factors, the BCA must take into account the overall economic interests, the competitiveness of the relevant industrial sector when compared with levels of competition internationally, and the interests of consumers. The notification process is free of charge and the decision-making process of the BCA is subject to strict deadlines.

Other regulatory or government approvals

Approval by the competent regulator may be required for acquisitions of companies which are subject to specific regulatory supervision, such as financial institutions, airports, telecom providers, etc.

Employment

Method of transfer under local law

Share sale

In a share purchase, all rights, duties and liabilities owed by, or to, the employees of the target company continue to be owed by, or to, the target company, also after the acquisition.

If there is an integration of the target company's business with the buyer's business post-acquisition, this is likely to constitute an acquisition of assets or a business transfer, and the considerations set out below will be relevant.

Asset sale

If the asset sale qualifies as a transfer of an undertaking or part of an undertaking within the meaning of the Belgian transfer of undertaking legislation (National Collective Bargaining Agreement 32bis - "**CBA 32**"), the employees of the seller's business will automatically transfer to the buyer with all rights and obligations (with the exception, in principle, of extra-legal pension rights). These employees do not have the right to refuse to transfer to the buyer. If the asset sale does not qualify as a transfer of undertaking with the meaning of CBA 32, then the employees will only transfer subject to their consent.

Approval or information/consultation requirements

Share sale

The works council is, in principle, to be informed upon the occurrence of events that are likely to have important consequences for the company. The fact that, as a result of a share deal, the company belongs to another group is often considered as triggering this obligation to inform the works council. Providing the works council with information should be done, if at all possible, at the latest when the news is disclosed to the public. A consultation of the works council is not required.

Asset sale

Whether or not the acquisition of assets/transfer of business qualifies as a transfer of undertaking within the meaning of CBA 32, the works council (if any) or in the absence of a works council, the internal trade union delegation, or in the absence of an internal trade union delegation, the committee for the protection and prevention at work (if any) ("**CPPT**") of the target company must be informed and consulted with at a time such information and consultation is still meaningful. It is usually considered that this information/consultation must take place before the final decision to transfer the assets/business is taken.

Provided that the sale of assets/transfer of a business qualifies as a transfer of an undertaking within the meaning of CBA 32, in the absence of a works council/trade union delegation/CPPT, the employees must be informed before the effective transfer. They must be informed about the contemplated date of the transfer, the reasons for the transfer, the contemplated measures towards the employees and the possible consequences of the transfer for the employees.

Protection against dismissal

If CBA 32 applies, the employees cannot be dismissed by reason of the transfer (be it by the buyer or the seller). If this prohibition is violated, the terminated employees may claim damages (in addition to the severance indemnity) which can amount to between 3 to 17 weeks' salary.

Tax

Share sale

The transfer of shares will generally not trigger any stamp duty in Belgium. A share transfer will generally be more beneficial for the seller than an asset deal, as capital gains realized in the context of a share deal are most often exempted from taxation. There is a notable exception for capital gains realized by resident individuals holding, or having held, (alone or with related parties) a participation of more than 25% in the Belgian company in which the shares are sold, when the sale is to a company or entity established outside the European Economic Area, or when there is a subsequent sale to such company or entity within a period of 12 months after the initial sale. This is why restrictions on further sale, disposal, merger, etc. are often included in the initial share purchase agreement when the seller is a resident individual holding such significant participation in the Belgian target.

Traditionally, share deals were less attractive for the buyer because of the absence of step-up in basis, and because it was difficult to offset any interest paid on the acquisition financing against income from the Belgian target due to the absence of tax consolidation (group relief) in Belgium. However, Belgium has introduced some tax consolidation rules, applicable since FY 2019, which allows them to partly remedy that situation.

Asset sale

Depending on the nature of the assets transferred, certain transfer taxes could become due. The sale of real estate (including heavy machinery that is immovable property by incorporation) will, as a rule, be subject to transfer tax of 10% or 12.5% (depending on the region where the assets are located) on the sales price or the fair market value, whichever is higher. The transfer tax is normally payable by the buyer, unless otherwise agreed upon between the parties. If a lease agreement is transferred, the transfer will also be subject to a transfer tax of 0.2% of the amount of the lease payments and charges which are still due under the remaining term of the contract (2% in the case of the transfer of a leasehold right).

Asset deals are generally less attractive for sellers because of the taxation of capital gains realized on that occasion, except if there are sufficient losses to offset such gains. With the recent introduction of minimum taxation rules in Belgium, even in the case where there are sufficient losses to offset such gains, an asset deal may still no longer be attractive for the seller. By contrast, the benefit of asset deals for buyers is that it allows them to obtain a step up in basis (i.e., higher depreciable amounts), including on goodwill which can be amortized for tax purposes.

Value added tax

While the sale of shares is normally exempt from Belgian VAT, the sale of assets is, as a general rule, subject to VAT at the standard rate of 21%. The transfer of certain assets (e.g., receivables) and the transfer of liabilities are, however, VAT exempt. The sale of buildings is subject to VAT only if the buildings are still new for VAT purposes, i.e., if they are transferred within a period of two years following the year of their first use. If input VAT has been deducted by the seller on the construction or renovation of the buildings, the transfer of those buildings without VAT within a period of 15 or respectively five years (calculated as of 1 January of the year during which the right to deduct the input VAT arose) will normally trigger a pro rata recapture at the level of the seller of (part of) the VAT initially deducted.

The VAT due at the occasion of the transfer is normally paid by the buyer to the seller, who is to remit that VAT to the authorities. If the buyer is entitled to fully deduct input VAT, the payment of that VAT sum to the seller merely entails a pre-financing cost. However, if the buyer is not entitled to fully deduct the input VAT, the non-deductible portion of the VAT due at the occasion of the transfer constitutes an actual cost for the buyer.

As an exception to the above rules, the transfer of assets and liabilities under an asset deal is exempt from VAT if it relates to an "entire business" or a "branch of activity" (so-called transfer of going concern or TOGC exemption). Transferred items constitute an "entire business" or a "branch of activity" if, for the buyer, they constitute a combination of elements allowing the buyer to carry on an independent economic activity. If all elements relating to an existing business are transferred, the TOGC exemption normally applies. If certain elements of the business are excluded from the transfer, it may be advisable to seek confirmation through a (formal or informal) ruling from the tax authority whether the TOGC exemption will be applied.

Avoiding tax and social security liabilities in an asset sale

In an asset deal, some special formalities should be observed by buyers to avoid joint liability with the seller for outstanding tax and social security liabilities.

If an asset deal qualifies as a transfer of "an entirety of goods composed of, among other things, elements which enable keeping the clientele", a copy of the transfer agreement must be filed with the relevant tax and social security authorities in order to make the transfer binding upon these authorities. The transfer will only be binding upon these authorities at the end of the month following the month of this notification. The buyer of the business may also incur joint liability for the tax (income tax and VAT) and social security liabilities of the seller up to the amount of the purchase price paid (or deemed paid) to the seller during the aforementioned period during which the transfer is not yet binding upon the relevant tax and social security authorities.

As an exception to this rule, a transfer will be immediately binding upon the relevant tax and social security authorities and there is no joint liability of the buyer for any outstanding liabilities of the seller if the seller obtains a "clean certificate" from the relevant tax and social security authorities (i.e., a document certifying that the seller does not have any outstanding liabilities vis-à-vis that particular authority) and the "clean certificate" is notified to the respective authorities at the same time as a copy of the transfer agreement. Note that the date on which the "clean certificate" was issued may only precede the date on which it is notified to the relevant authorities by a maximum of 30 days. To avoid last-minute complications, it is important to obtain any necessary "clean certificate" early in the process.

Note that in certain circumstances none of the above applies, i.e., where transfers are made in compliance with the procedures set out in the Code of Companies and Associations or provisions of foreign law applicable to the legal act when they offer equivalent protection to the creditor. In such circumstances, no risk of the assumption of joint liability for tax and social security will apply.

Post-acquisition integration

There are different legal corporate procedures available to achieve an effective post-acquisition integration.

Belgian employment law has strict requirements and procedures that apply to collective lay-offs, whether in the context of a post-acquisition integration or otherwise.

Common deal structures

What are the key private M&A deal structures?

In Belgium, the acquisition of businesses is often structured through the acquisition of shares in a company or by an acquisition of assets or the entire business or a business division of a company.

Auction processes are common in Belgium, and are typically governed by bid process letters. Most auction processes comprise two phases: a phase for non-binding indicative bid letters, and a phase for binding offer letters.

Mergers and demergers are less common methods of acquisitions in M&A deals; however, they are frequently implemented in intra-group re-organizations. Demergers are often used in the preparation for a subsequent third-party sale. The merger procedure results in the dissolution of the absorbed company, the automatic transfer to the absorbing company of all assets and liabilities of the absorbed company by operation of law (subject to a few limited exceptions), and (unless the absorbed company is a wholly-owned subsidiary of the absorbing company), the issuance of shares in the absorbing company to the shareholders of the absorbed company.

There is no specific legislation governing M&A in Belgium. The Belgian Code of Companies and Associations provides for merger and demerger procedures and optional corporate procedures for the transfer of a business division or the entire business of a Belgian company. There is separate legislation governing public offers.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

Limited liability companies in Belgium are the most commonly used form of corporate vehicle, in particular the *naamloze vennootschap/société anonyme* ("**NV/SA**") and the *besloten vennootschap /société à responsabilité limitée* ("**BV/SRL**").

What are the different types of limited liability companies?

The most commonly used types of limited liability companies in Belgium are the *naamloze vennootschap/société anonyme* (NV/SA) and the *besloten vennootschap /société à responsabilité limitée* (BV/SRL).

NV/SAs can be incorporated by one or more shareholders, the minimum share capital of an NV/SA is EUR 61,500 and shares can be issued with or without nominal value. Upon incorporation, the share capital must be fully underwritten and each share must be paid-up for at least 25%, with an overall minimum of EUR 61,500 in aggregate. Shares in NV/SAs are, in principle, freely transferable. Contractual restrictions on the free transfer of shares in NV/SAs are possible, but should be subject to time limitations and should always take into account the company's best interests. NV/SAs can be managed by either (i) a single director, (ii) a board of directors ("*conseil d'administration*" / "*raad van bestuur*") or (iii) a management board ("*conseil de direction*" / "*directieraad*") and a supervisory board ("*conseil de surveillance*" / "*raad van toezicht*"). The default option however is the board of directors ((ii)). The company's management is authorized to perform all actions not reserved to the general shareholders' meeting. Where applicable, the supervisory board will be responsible for the general policy and strategy of the company only, whereas the management board will be authorized to perform all actions not expressly allocated to the supervisory board or the shareholders' meeting. The company's management can adopt decisions by unanimous written consent (in lieu of a meeting).

Since the entry into force of the new Belgian Code of Companies and Associations, the SRL/BV has become in its basic legal appearance more straightforward and may become the "default" legal form for Belgian companies. The SRL/BV has been remodelled as a flexible company without capital requirements. The SRL/BV can be incorporated and can exist with only one shareholder. In addition, the legislator has provided for a lot of room for contractual structuring and more possibilities with respect to the type of securities (such as unlimited multiple voting rights or preference shares, profit-sharing certificates, warrants, and convertible bonds, etc.) and transferability of securities. BV/SRLs are managed by one or more directors, who need not necessarily act as a collegiate body. The management of the company is authorized to perform all actions not reserved to the general shareholders' meeting. The management of the company can adopt decisions by unanimous written consent (in lieu of a meeting).

Is there a restriction on shareholder numbers?

There is no maximum number of shareholders in Belgian companies.

A Belgian company NV/SA or BV/SRL type company must have at least one shareholder. In the case where an NV/SA has only one shareholder, certain filing obligations in this respect apply.

What are the key features of a share sale and purchase?

There is in theory no strict legal requirement that an agreement for the sale and purchase of shares must be in writing. However, agreements always tend to be in writing due to all parties wishing to have written evidence of their agreement. All parties should receive one copy of the fully executed original agreement and it is common, in practice, that each page of the agreement will be initialed by or on behalf of each of the parties for purposes of identifying the agreed pages. Electronic signatures however become more and more common.

The transfer of title to registered shares must be recorded in the target company's share register in order to ensure the enforceability of the rights arising from the transfer against third parties and the company itself. The transfer of title to dematerialized shares is effected by moving the registration from one securities account to another.

What are the key features of an asset sale and purchase?

Special rules may apply to the sale and transfer of specific assets such as real estate (which requires a notary deed) and trade marks (which require specific registration formalities). Transfers by operation of law of the entire business or a business division of a Belgian company require the advance filing of special forms with the clerk's office of the relevant Business Court, as well as, in certain cases, the execution of notary deeds to complete the transfer.

Unless parties opt to apply the specific procedure provided for in the Belgian Code of Companies and Associations for the transfer of the entire business or a business division of a Belgian company by operation of law, no specific procedure is required to transfer title of the assets of a business as a going concern. Parties merely enter into a sale and purchase agreement, which will make the sale and purchase binding between them. Depending on the assets being transferred, however, certain formalities must be complied with to perfect the transfer of the relevant assets. Unless the contract provides otherwise, the obligations under a contract are not assignable by a party to such contract to a third party without the consent of the other party or parties to the contract. Transfer of the benefits under a contract (if not prohibited under a contract) must be notified to the relevant other party or parties to the contract, unless the benefits constitute a business division or the entire business of a company.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

Letters of intent and term sheets are customary. Typically, letters of intent and term sheets are not intended to create legal rights or obligations upon the parties, except for certain specific agreed upon provisions (such as confidentiality undertakings), and therefore do not constitute a binding agreement for an acquisition. Such binding agreement is only entered into after further negotiations between the parties.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: Exclusivity provisions are customarily included in terms sheets;
- Break fee: Break fee provisions are not customarily included in term sheets;
- Confidentiality: Confidentiality provisions are customarily included in term sheets.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Parties usually negotiate separate confidentiality or non-disclosure agreements. Exclusivity and break fee provisions are sometimes included as part of a term sheet or letter of intent, and other times included in a separate document.

Is there a duty or obligation to negotiate in good faith?

Under Belgian law, parties negotiating a transaction, including a sale and purchase of shares, assets or a business are under a general obligation to conduct the negotiations in good faith. This entails, among other things, that negotiations which are at a reasonably advanced stage, can in principle not be terminated unilaterally without due and reasonable justification. In the event of a breach of pre-contractual obligations, the party in breach (and possibly its representatives) can be held liable.

Agreeing the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: fairly common; purchase price adjustments are common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: we commonly see adjustments for net (financial) debt and/or working capital. Adjustments for NAV (net asset value) are rare, except in certain specific industries (financial institutions). Fixed prices (locked box) are common.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely; collars are rare, but not unheard of either.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually prepared by the buyer.

Is the balance sheet audited (where applicable)?

Frequency/market practice: fairly common.

Is an earn-out common?

Frequency/market practice: earn-outs are rarely used, except in buyer-friendly circumstances and smaller transactions.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: fairly common.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: rarely (often heavily resisted by sellers).

Is the MAE general or specific?

Frequency/market practice: if there is an MAE, it is usually target-specific but general in scope.

Is the MAE quantified?

Frequency/market practice: fairly common.

Covenants

Is a non-compete common?

Frequency/market practice: this is fairly common but not from private equity sellers. Waterfall provisions are rare.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: general blue pencil/severability provisions (not specifically related to non-compete covenants) are fairly common.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common (in conjunction with a non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: fairly common, subject to competition law restrictions ('gun-jumping').

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: rarely; but not unseen either. There are competition law issues around potential 'gun-jumping'.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: fairly common; updating the warranty disclosure and notification of possible breach between signing and closing are fairly common. It is, however, often agreed that the update must not prevent or limit the purchaser's right to indemnification. The purchaser's right to walk away in the case of a material update/breach between signing and closing may be negotiated (in the absence of an MAE). This said, sometimes business warranties are not repeated at closing, and then of course also no update of disclosure applies.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen, but are sometimes not quantified.

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are fairly common. They are often limited to the actual knowledge of a specified list of senior management, but sometimes expanded with imputed knowledge as well.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common.

Is disclosure of the data room common?

Frequency/market practice: very common.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: repetition at completion is fairly common, but there are also more and more deals where business warranties are not repeated at closing.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: rarely.

Is a bring-down certificate at closing common?

Frequency/market practice: bring-down certificates are rarely used (and any other kind of closing certificate is rare).

What is the applicable repetition, standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and correct. Material Adverse Effect or "in all material respects" qualifications are applied at times, but not routinely.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: it is commonly 10%-20% for warranties (other than key warranties (e.g., title, capitalization, authority)). Also fairly common is a cap of 100% of the purchase price for the seller's liability under the purchase agreement for all warranties (including key warranties) (subject to certain carve-outs).

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: they usually apply to warranties only.

What are the common exceptions to the cap?

Frequency/market practice: key warranties are often excepted (e.g., title, capitalization, authority) from the warranty cap. Where there is fraud by the seller, the limitations (including cap) are not applicable.

Is a deductible or basket common?

Frequency/market practice: a deductible is more often resisted and a tipping basket is fairly common.

Is a de minimis common?

Frequency/market practice: common.

How long does seller liability survive?

Frequency/market practice: a general survival of 18-24 months is fairly common. Tax, social security and key warranties are commonly longer than general warranties (statute of limitations). Environmental warranties can survive longer.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: it is fairly common to explicitly carve out key warranties and fraud.

Is warranty insurance common?

Frequency/market practice: more and more common.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common for actually received.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common for actually received.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: very common; this is required by law.

Is there an exclusion of consequential damages?

Frequency/market practice: increasingly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: it is fairly common to provide for a warranty from the buyer where, except for the disclosures, their deal team members are not actually aware of any breach of the seller's warranties (at signing).

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: local law allows for a choice of governing law.

What is the common governing law?

Frequency/market practice: Belgian law is the common governing law.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: both litigation and arbitration are fairly common. The arbitration location is often in Belgium under local arbitration rules.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: stamp duty is not applicable.

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: it is rare to have a separate tax deed or tax covenants. Tax warranties and (specific) tax indemnities are fairly common.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Brazil

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

In Brazil, it is customary to finalize the due diligence prior to the execution of the acquisition agreement. Nevertheless, in some cases, the parties may agree that further confirmatory due diligence regarding certain aspects of the target company will be a condition precedent to closing (e.g., completion of phase two environmental due diligence).

The main areas of concern in the due diligence process vary from project to project. Compliance, environmental, regulatory, labor and tax issues are always in the spotlight of any legal due diligence work. It is important to note that, in Brazil, due diligence does not trigger obligations to report any issues found to regulators.

Based on the due diligence findings, the parties may negotiate special closing conditions, an escrow account to deposit part of the purchase price to guarantee seller's indemnification obligations may be opened, or the purchase price may be reduced.

Independent appraisal

In the case of a share deal, it is not legally required to have an independent appraisal report to support the valuation of the target company. However, if the buyer intends to benefit from the tax amortization of the goodwill paid in the transaction, the buyer will need an appraisal to support the purchase price and certain other conditions must be observed. In this context, "goodwill" means the difference between the acquisition price and the book value of the shares acquired in the target company. For example, the acquisition must be made through a company organized in Brazil and a subsequent reorganization of the acquisition vehicle/buyer and the target company must take place via a downstream or upstream merger.

In the case of an asset deal, in general there is no need to have an independent appraisal to support the valuation of the assets.

Payment

If the seller is Brazilian, the payment of the purchase price must be made in Brazil even if the buyer is not Brazilian. The purchase price can be remitted in foreign currency to the seller's bank account in Brazil and the seller will be responsible for converting it into Brazilian currency. Note that a financial tax (*imposto sobre operacoes financeiras*, or IOF) at the rate of 0.38% will be due upon the conversion.[1]

Every time there is a foreign party involved in a share deal as either the buyer or seller, the Brazilian target will need to register the transaction with the Central Bank of Brazil ("**BACEN**"), as described in greater detail below.

[1] Due to coronavirus pandemic (COVID-19), Brazilian Federal Executive Branch enacted Decree No. 10,305/2020 which temporally reduced to zero the IOF rates applied to all credit operations concluded from April 3 2020 through July 3 2020.

Signing/closing

Share sale

Apart from a merger control filing (as described below) and for approvals related to specific regulated industries (e.g., energy or telecomm companies, financial institutions, insurance companies), government approval is not required as a condition to closing and a simultaneous signing and closing is possible.

Closing conditions will also depend on the issues raised during the due diligence exercise and/or on the commercial conditions agreed between the parties to complete the transaction (e.g., repayment of intercompany loans, obtaining of approval from suppliers or creditors).

Asset sale

Unless the foreign buyer already has an existing entity with the requisite business scope and licenses in Brazil to acquire and operate the assets, there will normally be a gap between signing and closing.

If an existing Brazilian subsidiary of the foreign buyer acts as the asset buyer, it is necessary to ensure that its business scope is broad enough to cover the acquired business post-closing and that it has the required licenses and registrations. An amendment to the business scope may be implemented through an amendment to the articles of association or a shareholders' meeting approving an amendment to the bylaws. Both the amendment to the articles and the bylaws must be registered with the competent State Commercial Registry. It may also be necessary for the buyer to establish additional branches to operate the business if the acquired business is in a different location from where the subsidiary is registered.

If the foreign buyer does not have an existing subsidiary or affiliate located in Brazil, the buyer will need to take all the measures required to organize a company in Brazil, by obtaining the licenses and registrations needed to receive the business/assets to be acquired and, afterwards, transfer the assets under the asset sale. The establishment of an entity may take approximately one month to complete; this timeline may be extended to a few months, where specific licenses are required, as is the case for manufacturing.

In multijurisdictional transactions, a local asset sale/transfer agreement is needed to comply with local requirements, especially to allocate the purchase price among the assets being transferred in Brazil.

Approvals/registrations

Foreign investment

Since the unification of the free rate and the floating rate exchange markets in March 2005, the Brazilian Government, through the Brazilian Monetary Council ("**CMN**") and the Central Bank of Brazil ("**BACEN**"), have introduced new rules aimed at making the currency exchange market simpler and the controls over such market more flexible. Such changes include rules related to import and export transactions, and inflows and outflows of funds of small amounts. As of 2 February 2014, new Rulings came into force to make the regulations clearer and more user-friendly, eliminating redundant or unnecessary provisions and harmonizing the rules applicable to similar situations.

Therefore, Brazilian foreign exchange control rules require that foreign investments in Brazilian companies be registered with the BACEN to enable:

- the remittance of profits and/or interest on equity (*juros sobre capital próprio*) to foreign investors;
- the repatriation of foreign capital invested in Brazil; and

- the reinvestment of profit and/or interest on equity. For this purpose, both the foreign investor and the Brazilian company are required to register with the BACEN.

The Brazilian target company will be responsible for registering the foreign investment with the declaratory system of the Central Bank within 30 days from the date that the investment is made, subject to fines for late or non-registration.

Merger control

The Brazilian antitrust authority ("**CADE**") must be notified of both the acquisition of stock and assets in a Brazilian entity if the following filing thresholds are met:

- one of the parties to the transaction has gross revenues in Brazil in excess of BRL 750 million (approximately USD 234 million) in the year prior to the transaction; and
- at least one other party involved has gross revenues in Brazil in excess of BRL 75 million (approximately USD 23.4 million).

The gross revenues to be considered are those of the parties' economic group (not just gross revenues of buyer, seller and the target). For the purposes of defining "economic group," Brazilian regulations require consideration of: (i) all companies that are controlled directly or indirectly by the same parent company or individual and (ii) all companies in which any of the companies identified in item (i) holds a participation in excess of 20% (directly or indirectly) in the corporate or voting capital. The authorities may request the notification of any transaction that does not meet these thresholds for up to one year after closing, with powers to order divestitures.

When a filing with CADE is required, the closing of the transaction will be subject to the prior approval by the Brazilian antitrust authorities. The maximum review period is 330 calendar days.

There is also a fast-track procedure for the review of simple cases that have no or very little possibility of causing competitive harm, such as: (i) classic or cooperative joint ventures; (ii) consolidation of control; (iii) substitution of an economic agent; and (iv) low market share acquisitions (defined as less than 20% of horizontal overlap or less than 20% of market share in vertically integrated markets). The fast-track procedure is applied at the authorities' discretion and, although there is no formal deadline, the authorities have fixed an internal informal period of up to 30 calendar days to review these cases. This period has typically been observed so far. Once the transaction is approved by the Brazilian antitrust authorities, the parties must wait an additional period of 15 days to complete the transaction.

Other regulatory or government approvals

For acquisitions of control of financial institutions and of companies operating in certain other sectors, such as telecommunications, energy, ports and insurance, the approval from the relevant industry regulator is required. The definition of control varies according to the rules of the specific industry regulatory authority.

Furthermore, when the investor is foreign, shares of companies operating in certain sectors (e.g., telecommunications) must be held through a Brazilian vehicle/company. There are also limitations on the indirect share ownership by foreign investors exceeding certain thresholds in specific sectors (e.g., newspapers and news companies, as well as airlines).

Employment

Share sale: In the case of share acquisitions, there is no change in the employer/employee relationship and consent from employees or unions is not required. Notice to employees is also not required given that the employer remains the same.

Asset sale: In the case of an asset acquisition that involves the transfer of a business as an ongoing concern, Brazilian law allows either the continuation or the termination of the employment relationship.

The transfer of employees as a result of the transfer of the business does not require the termination of the employment agreements, which would trigger certain severance payments.

Labor law allows for the transfer of employment agreements to the acquiring company because the employees are transferred together with the assets, as a part of the economic activity. In this case, however, the new employer is the legal successor and solely liable for the employees' labor liabilities.

The employee transfer procedure is fairly simple and is formalized by certain annotations made in the employee's labor booklet (*Carteira de Trabalho*) and in the acquiring company's employee records. Certain bureaucratic procedures, such as the communication to the labor authorities, must be made through the "eSocial", which is a mandatory governmental bookkeeping service that contains the employees and employers necessary information regarding the work relationship.

There is usually no legal obligation to consult with the union or the employees regarding the transfer of the employees in conjunction with the business/assets unless the applicable collective bargaining agreement provides otherwise. However, this is uncommon in practice.

The parties to an asset acquisition may also agree that the seller will terminate its employees, who will be immediately rehired by the buyer. Although this procedure is very expensive for the seller, it may give the buyer some comfort, as the amounts in dispute may be reduced. A payment of at least certain amount/rights would typically be made by the previous employer (the seller). As such, assuming that the amounts are correctly paid, the buyer would then be responsible for possible differences only.

Tax

There is no stamp duty in Brazil.

For Brazilian corporate sellers, capital gains will form part of their taxable income and will be subject to corporate income taxes (IRPJ/CSLL) at a combined rate of 34% (with the exception of financial institutions, which will be subject to a combined rate of 45%).

For Brazilian individuals, capital gains will be subject to income tax at progressive rates that range from 15% to 22.5%, depending on the amount of gains.

For foreign sellers (both individuals and entities) of shares, capital gains will also be subject to income tax at the progressive 15% to 22.5% rates, unless the foreign seller is domiciled in a jurisdiction defined by Brazilian tax rules as a low tax jurisdiction, in which case a 25% flat rate will apply.

For cross-border remittances of the purchase price, a 0.38% financial tax (IOF) will apply on the exchange transaction performed to remit or receive the purchase price to or from abroad.

Post-acquisition integration

It is critical to plan for post-acquisition integration well in advance of closing, particularly in the case of regulated business requiring specific registrations. Obtaining or transferring such registrations can be time consuming (e.g., product registration within the healthcare industry).

The parties may need to develop a plan and agree on certain transition agreements to establish the rights and obligations (including indemnity rights) of each party to operate the business until the completion of such transfer of registrations. It is common to start discussing the integration plan with the client when the due diligence is finalized or in parallel with the discussion of the transactional documents with the seller.

Common deal structures

What are the key private M&A deal structures?

The acquisition of a business may be achieved by purchasing either the shares of the company that operates the business or the assets and liabilities pertaining to the business. Share acquisitions are more common than asset acquisitions in Brazil, as they are less burdensome from a bureaucratic point of view and, depending on the circumstances, may also be more tax-efficient. Each type of acquisition has its own advantages and disadvantages, and the choice of the structure will largely depend on the circumstances of the transaction and, in particular, the parties' tax considerations.

The acquisition of a company or business in Brazil does not require government consent, except for merger control approval if the parties' gross annual turnover is above antitrust thresholds, or where the transactions involve regulated activities controlled by the government. Nevertheless, the transaction may trigger the application of various laws and rules aimed at protecting the rights of parties or persons.

Auction processes in Brazil are quite common, usually preceded by bid process letters. Usually, the negotiations start with a letter of intent and bids are issued as non-binding offers. However, depending on the process, bid letters may be binding, particularly in the final offer stage of the process.

Scheme of arrangement procedures are not addressed in Brazilian legal framework.

In Brazil, the following types of mergers are available: horizontal, vertical, market extension, product extension and conglomeration. In general, vertical mergers in which two or more companies operating in the same supply chain merge are the most common types of mergers in Brazil.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

A *Sociedade Limitada (limitada)* is generally considered a more flexible form of a limited liability company. *A Sociedade Anônima* (SA) is another common form of private company.

What are the different types of limited liability companies?

The two most common types of limited liability companies are the following:

- *Sociedade Anônima* (SA), a limited liability corporation; or
- *Sociedade Limitada* (limitada), a more flexible form of a limited liability company.

These types of companies are the most popular with non-resident investors in Brazil. In 2011, Brazilian authorities enacted new rules authorizing the incorporation of another type of legal entity in Brazil: the so-called Individual Company of Limited Liability ("**EIRELI**"), a limited liability entity owned by a sole owner. This additional corporate form is not commonly chosen by investors organizing their business in Brazil.

In an SA, shareholders' liability is limited to the amount of capital invested by each shareholder. This type of corporation may be closely held ("*capital fechado*") or publicly held ("*capital aberto*").

An SA must have at least two shareholders, which may be either entities or individuals. There are no residency or nationality requirements; however, a shareholder that is not a Brazilian resident must appoint an attorney-in-fact resident in Brazil vested with powers to receive court summons on its behalf.

At least 10% of the stated capital must be paid-up in cash at the time of the SA's incorporation. No minimum capital is required, except to carry out certain regulated activities, e.g., for banking, insurance and trading companies. The capital of the SA is divided into shares. According to the rights attributed to their holders, the shares may also be qualified as ordinary or preferred.

Organizing a *limitada* may be more flexible since: (i) it involves lower costs, both in organization and management; (ii) its Articles of Organization may be amended by a simple document executed by the company's partners or their attorneys-in-fact, and the publication of the amendment in the official gazette and newspaper is not required; (iii) no stock certificates or corporate book such as share registration, share transfer book, shareholders and board meeting's minute books, are required; and (iv) as of 2019, *limitadas* are now allowed to have a single quotaholder. In an Ltda, all corporate information is addressed in its Articles of Organization. For this reason, the limitada's structure is often used to incorporate wholly owned subsidiaries (including purchase vehicles for local acquisitions) in Brazil. The liability of quotaholders is also limited to the amount of the capital invested by each quotaholder, but if the capital is not fully paid-in, quotaholders are liable for the payment of the full amount of the company's capital.

Is there a restriction on shareholder numbers?

An SA must have at least two shareholders, which may be entities or individuals. As to the limitada, as of 2019 with the enactment of The Economic Freedom Act (Law No. 13.874), the so-called sole quotaholder limited liability companies are now allowed in Brazil, eliminating the need for a nominee quotaholder, typically holding only one quota, which may be an entity or individual. The EIRELI must have a single equity holder, which can be an individual or an entity.

What are the key features of a share sale and purchase?

From a transactional point of view, a share (or quota) transaction is much simpler and involves less documentation than an asset transaction. No individual transfers of title to the company's assets and inventory are required and no cumbersome formalities need to be observed. Normally, public licenses and permits are not affected by a change in the control of the target company. As a general rule, unless a contract or agreement expressly requires prior consent before the transfer of control (common in contracts with the public sector, but not necessarily an obstacle), the company's rights and obligations under its contracts and agreements are not affected. A share acquisition also offers more flexibility in terms of tax planning.

What are the key features of an asset sale and purchase?

Asset acquisitions tend to be much more complicated than share acquisitions as each asset and liability to be included in the sale has to be identified and transferred, individually or by legal category (e.g., each equipment and inventory item must be described, valued and quantified in the transfer invoices to be delivered by seller to buyer). In some cases, the issuance of these transfer invoices may trigger transfer taxes. The title to real properties is transferred through the registration of deeds that trigger the payment of tax and notarial fees.

The parties do not need to transfer the whole business and are generally free to select the assets and liabilities they wish to transfer. In general, the buyer is liable only for obligations acquired, which the buyer assumes expressly in the purchase agreement. There are, however, certain exceptions where the buyer assumes certain liabilities of the seller by the operation of law, e.g., tax, labor and environmental liabilities.

This risk of inheriting hidden liabilities, as well as the time-consuming procedural requirements, tends to dissuade some buyers from electing asset deals as an acquisition vehicle in Brazil.

Some public licenses and governmental permits may not be transferred along with the business, in which case a new one must be applied by the buyer. Buyers should therefore obtain all necessary governmental licenses before completion of an asset deal to avoid any interruption to business and the risk of incurring penalties.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

Parties in a negotiation typically start with a letter of intent or term sheet. Although in many cases buyers may proceed in negotiations with sellers using such letters of intent (stipulating only a few provisions which are intended to be legally binding like confidentiality and exclusivity), under Brazilian law, these pre-contractual letters will not necessarily have legal effect because whether or not a letter will create legal obligations depends on the substance of what is said and not on its format. If the letter of intent has the same basic elements of the definitive agreement, such as the target company and the price, there is a risk that the letter of intent may be deemed to be binding.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: Where letters of intent and term sheets have been prepared, it is fairly common to include binding provisions on exclusivity.
- Break fee: Break fees are rarely used.
- Confidentiality: Where letters of intent and term sheets have been prepared, it is common to include binding provisions on confidentiality.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

It is very common to negotiate separate confidentiality agreements or non-disclosure agreements. It is less common to negotiate separate exclusivity agreements because exclusivity provisions are more often included in letters of intent or term sheets.

Is there a duty or obligation to negotiate in good faith?

Under Brazilian law, the parties are deemed to act in good faith. Therefore, if the letter of intent has the same basic elements of the definitive agreements, such as the target company and the price, there is a risk that the letter of intent be deemed to be binding. In this event, if one of the parties gives up the deal, the other party can claim damages. The best way to address that is to expressly set forth in the letter of intent whether or not the parties are bound to close the deal or if it is just an initial step for further negotiations. It is not unusual to provide for break-up fees in the letter of intent, which would prevail over any claim of damages.

Agreeing to the acquisition agreement

Purpose price

Is a purchase price adjustment common?

Frequency/market practice: purchase price adjustments are common and may even be negotiated when signing and closing are simultaneous, in view of the length of time that may elapse from the date of the base balance sheet for valuation purposes and the actual closing.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: different types of price adjustments are seen, including cash-free debt-free, working capital and NAV adjustments.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely; collars are not common, but not unheard of either.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually prepared shortly after the transaction closing by the buyer or an independent appraiser appointed by the buyer.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely; except for listed companies, large scale companies (entities or group of entities under common control with assets in amount higher than BRL 240,000,000 in the latest fiscal year or annual gross earnings in amount higher than BRL 300,000,000), multinational subsidiaries or entities involved in activities regulated by the government, most Brazilian companies are not audited.

Is an earn-out common?

Frequency/market practice: earn-outs are fairly common, especially in transactions where the sellers continue to manage the target company after closing and in private equity transactions.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: escrows are very common. The escrow account is the most common guarantee in private M&A transactions involving a Brazilian target business. A holdback is rare, even if in Brazil an escrow account can only be maintained with financial institutions that charge fees for their services. In Brazil, it is quite common to have escrow funds applied in interest-bearing financial applications.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common; however, it is also common to have transactions where signing and closing are simultaneous without condition.

Is the MAE general or specific?

Frequency/market practice: both are seen. Sellers usually demand it to be specific.

Is the MAE quantified?

Frequency/market practice: rarely.

Covenants

Is a non-compete common?

Frequency/market practice: it is common for a maximum term of five years with a clear definition of the applicable territory. Non-competes are also foreseen by law. For enforceability, it is expressly provided that the party bound by the non-compete receives compensation.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: waterfall and blue pencil provisions are not common.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common.

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common; combined with non-compete.

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: fairly common.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: fairly common; updating schedules is common, as is the insertion of a clause requesting the seller to notify the buyer of a possible breach. This may trigger termination or price adjustment.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: materiality qualifiers are common, but are often not quantified (other than specific warranties, e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are increasingly common, usually including actual knowledge or matters that should have been known upon due inquiry. Listing individuals is not common.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common.

Is disclosure of the data room common?

Frequency/market practice: usually, disclosure of the data room is not accepted as a liability limitation.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common; in some cases, the parties execute a closing memorandum or similar document addressing any amendments in the warranties and confirming those that have not suffered any changes.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: it is common to have a statement in the R&W section saying that the warranties are true for signing and will continue to be for closing.

Is a bring-down certificate at closing common?

Frequency/market practice: fairly common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: both are seen separately, but usually true and accurate in all material aspects.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely; double materiality is usually avoided.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: the buyer often starts negotiations asking for a cap of 100% of the purchase price. Some obligations, such as non-compete, may have a higher cap, depending on the size of the deal. Lower caps may be negotiated.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: usually, the cap applies to all obligations of the agreement, except for certain obligations that, depending on the amount of the deal, may be excluded from the cap, e.g., non-compete or confidentiality obligations.

What are the common exceptions to the cap?

Frequency/market practice: this depends on the size of the deal and non-compete/non-disclosure provisions.

Is a deductible or basket common?

Frequency/market practice: both are common; it varies from case to case.

Is a de minimis common?

Frequency/market practice: fairly common; it varies case by case.

How long does seller liability survive?

Frequency/market practice: it usually survives for five years, in line with the statute of limitation for tax and labor liabilities. However, a reduced period is sometimes seen.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: yes, all those carve outs apply.

Is warranty insurance common?

Frequency/market practice: this is fairly uncommon as it is still an expensive tool only recently introduced in the Brazilian market.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: rarely.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: rarely.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: rarely.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: rarely, except that generally sellers will ask buyers to commit to refrain from self-denouncing certain unmaterialized pre-closing liabilities identified during the due diligence to the authorities after the closing

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common; by operation of law, consequential damages are excluded.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: fairly common; this is usually claimed by the seller, but often successfully resisted by buyers.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: Brazilian law only allows for a choice of governing law where arbitration is the conflict resolution option in the contract. If litigation is chosen, it is not possible to make a choice of governing law. Under Brazilian law, when parties choose litigation, the jurisdiction where the contract was entered into will determine the governing law and, whenever it is not possible to determine the place of the contract, Brazilian law presumes that the contract was perfected in the place of business of the party who makes the binding offer; the proponent of the deal.

What is the common governing law?

Frequency/market practice: Brazilian law.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is more common. The location varies from case to case.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: none.

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: it is fairly common to have specific tax indemnity included in the purchase agreement.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

Guide to Navigating Global Private M&A

Canada

Quick reference guide

Due diligence, pricing and closing

Due diligence in Canada is generally fulsome and buyers of businesses in Canada can inherit litigation, anti-bribery, environmental, employee severance, labor union, tax and other risks upon completion of an acquisition. Recently, privacy, anti-bribery, import/export, information security and related matters have risen in prominence as due diligence matters as a result of increased regulatory attention to compliance in Canada.

Pricing and payment

Wire transfer of funds is common and wire transfers through the SWIFT Code international system are also common.

Canada does not exercise currency exchange controls.

Signing/closing

Simultaneous signing/closing is relatively common, particularly in transactions where no antitrust approval is required.

Approvals/registrations

Foreign acquisitions of Canadian businesses are assisted by a general absence of exchange controls, and include government regulation, or licensing of most foreign investment or foreign acquisitions in Canada. Below are the typical approval requirements.

Foreign investment (Investment Canada Act)

Foreign investment in Canada is regulated by the Investment Canada Act ("**ICA**"). Generally speaking, a foreign investor seeking to directly acquire control of an established Canadian business valued at or abovea prescribed financial threshold must apply for review of the investment's likely net benefit to Canada, and may not complete the acquisition until approval is obtained. The review threshold differs for investments from World Trade Organization ("**WTO**") member countries ("**WTO Investors**"), private investors from countries with which Canada has trade agreements, state-owned investors, non-WTO investors and investments in Canadian cultural businesses.

For all other investments valued below the relevant threshold, investors need only file a notification, which may be done post-closing, and the investment is not reviewable for net benefit. A similar notification is required when an investor from a WTO member country indirectly acquires control of an existing Canadian business or when a foreign investor establishes a new business in Canada.

The ICA also contains an independent discretionary national security review regime (similar to CFIUS in the US) that applies to all acquisitions by foreign investors, regardless of value or level of ownership acquired (it can apply to minority acquisitions), and can result in conditions or prohibition if an acquisition is found likely to be injurious to Canada's national security. In the case of a reviewable investment, national security review will generally be conducted in parallel with net benefit review. For notifiable investments, while the ICA does not allow for voluntarily pre-clearance of transactions on national security grounds, investors can obtain certainty by filing the post-closing notification prior to closing, allowing for the expiry of the initial national security screening period.

Merger control

The Canadian merger control regime governed by the *Competition Act* contains premerger notification provisions, as well as substantive merger provisions, which apply independently of each other.

If an "operating business" is acquired and the acquisition is of a specific type, is not subject to an exemption and meets both of the following financial thresholds, a premerger notification must be filed with the Competition Bureau; the federal agency responsible for merger review and clearance.

- "Size of Parties" Threshold. The parties to the transaction, together with their affiliates, have combined assets in Canada or combined gross annual revenues from sales in, from or into Canada exceeding CAD 400 million.
- "Size of Transaction" Threshold. The Canadian business being acquired has a book value of Canadian assets or gross annual revenues from sales in or from Canada generated from those assets exceeding CAD 96 million (for 2020). This threshold is revised annually based on changes to the Canadian gross domestic product (with the next adjustment expected in the first quarter of 2018).

Even if both of the above thresholds are met, acquisitions of a corporation's voting shares are notifiable only if the purchaser acquires 20% or more of a public company's voting shares (50% or more if the purchaser already owns 20% of the shares) or 35% or more of a private company's voting shares (50% or more if the purchaser already owns 35%).

All merger transactions, whether or not they are notifiable, are subject to examination on substantive grounds to determine whether they have, or are likely to have, the effect of preventing or substantially lessening competition in a definable market. Although a number of factors are considered when assessing the effect of a transaction on competition, market concentration is commonly one of the most important factors. Generally, a combined market share of 35% or less will not be likely to attract the Competition Bureau's attention. Any transaction, irrespective of size, can be reviewed on substantive grounds for up to one year post-closing and review of non-notifiable transaction that may present competitive concerns is becoming increasingly common.

Other regulatory or government approvals

The purchase and sale of securities, including the shares of a corporation and ownership interests in many other entities, are strictly regulated by both federal and provincial or territorial governments.

A non-Canadian company may issue shares or other securities in Canada to finance an acquisition, for example by exchanging its shares for the shares or assets of the target company. If the target is a public company, the circular or applicable documentation delivered to shareholders must contain prospectus-level disclosure and be filed with the securities regulatory authorities, but it is typically not subject to formal review.

Tax

Many factors must be considered in structuring the acquisition, including tax and accounting considerations, regulatory requirements and management issues. Many of these apply in domestic transactions, although they tend to be more complicated in a cross-border acquisition.

Share sales

The acquisition of shares of a private company is generally simpler than asset acquisitions, especially if there are only a few shareholders and all are willing to sell. It is customary to include the same full set of disclosure provisions in either a share or an asset acquisition agreement. In a formal takeover bid for a public company (discussed below), the form of offering circular (that is to be delivered to shareholders and filed with the securities regulatory authorities) is prescribed by securities law. While it must be certified by certain officers and directors of the offeror that it does not contain a misrepresentation, it is not automatically subject to formal review by the securities regulatory authorities.

Where shares are acquired, all assets remain in the target company and few transfer documents are required. Thus, the acquisition of a private company may be completed fairly quickly. The target company will retain all of its assets, including its licenses, permits and franchises. In an asset transaction, these can be difficult to transfer because of the need to obtain consents from the issuing government agencies. In addition, unlike in asset acquisitions, third-party consents for the assignment of important contracts and leases will generally not be required, unless they contain change of control clauses.

In a share acquisition, the target company will usually retain its tax attributes, both favorable and unfavorable, assuming that the business is continued. There are, however, limitations on the future use of some attributes, such as net operating losses. A higher purchase price paid for the business will generally not be reflected in the tax basis of the target corporation's assets after the acquisition (although a "bump" in the tax basis of certain of the corporation's assets may be available in some circumstances). A share acquisition can also be cumbersome if the buyer does not wish to purchase the target company in its entirety. In certain cases, it may be possible for the target to rid itself of the unwanted business or assets prior to a share acquisition. However, both the legal and tax aspects of a spin-off (or corporate split) can be complicated in Canada.

A Canadian resident shareholder will generally be liable for income tax on the sale of shares. The amount of tax is generally based on the difference (i.e., the "gain") between the sale proceeds (or fair market value for dispositions to related parties) and the seller's adjusted cost base in the shares (generally the cost of the shares to the seller). The gain is generally taxed as a capital gain, i.e., one-half of the gain is included in the seller's income and taxed at the seller's combined (i.e., federal and provincial) marginal income tax rates. Subject to relief under a tax treaty, a non-resident shareholder may also be liable for Canadian income tax on the sale of certain shares (i.e., shares that constitute "taxable Canadian property" under the Canada Income Tax Act, which very generally are shares that derive more than 50% of their value from real or immovable property in the 60 months prior to the disposition). A Canadian resident purchaser of taxable Canadian property from a non-resident seller may be required to withhold 25% of the purchase price (unless the seller provides a certificate of compliance from the Canada Revenue Agency).

In general, the transfer of shares is an exempt supply under the Canada Excise Tax Act and, therefore, not subject to goods and services tax/harmonized sales tax (GST/HST). No stamp duty is payable by purchasers on the acquisition of shares in Canada.

Asset sale

In an asset acquisition, the buyer or its subsidiary acquires specified assets and liabilities of the target company. This may comprise "substantially all" of the target's assets or only a division or line of business. The seller retains those assets and liabilities not acquired by the buyer. Clear identification of the specific assets to be transferred and the specific liabilities to be assumed is critical in an asset acquisition.

Advantages

If assets are acquired, the buyer's tax basis in the assets will generally reflect the actual purchase price (subject to certain limitations generally applicable to non-arm's length transfers). As noted above, not all the assets of the target company need to be purchased. Therefore, if one is interested in only one line of business or one division of a company, an asset purchase is the most straightforward way to accomplish the transaction.

Another benefit of an asset acquisition is that not all liabilities need to be acquired. However, certain liabilities may pass to the buyer in any case.

Substantial liabilities may pass to the buyer under some circumstances. For example, environmental liabilities may become the responsibility of any subsequent owner. Buyers typically want full disclosure of any such problem, which includes any failure by the business to comply with environmental laws or any environmental permits for day-to-day operations. Extensive laws regarding product liability and compensation for damages sustained by users of products exist in Canada. In an acquisition, the buyer is often concerned about assuming responsibility for products sold prior to the acquisition. In Canada, the seller will usually indemnify the buyer against any such liabilities in the acquisition agreement, which may be sufficient protection if the seller is financially sound.

If the selling company is insolvent, great care must be taken to avoid any charge of fraudulent conveyance, that is, a disposition of assets for inadequate consideration while a company is insolvent or that causes it to become so. Fraudulent conveyance can be actionable by a company's creditors.

A Canadian resident seller will generally be liable for income tax on the sale of assets. The amount of tax is generally based on the difference between the sale proceeds (or fair market value for dispositions to related parties) and the seller's tax cost in the assets (generally the cost of the assets to the seller). The gain is generally taxed as a capital gain (see above). Assets that are depreciable property may be subject to recapture (treated as income). The gain on some assets (e.g., inventory) will generally be taxed as ordinary income (i.e., fully includible). Subject to relief under a tax treaty, a non-resident shareholder may also be liable for Canadian income tax on the sale of certain assets (i.e., assets that constitute "taxable Canadian property" under the Canada Income Tax Act). A Canadian resident purchaser of taxable Canadian property from a non-resident seller may be required to withhold 25% of the purchase price (unless the seller provides a certificate of compliance from the Canada Revenue Agency).

The sale of assets may be subject to sales tax (i.e., GST/HST and/or Quebec or provincial sales tax). Where there is a sale of all or substantially all of the assets of a business or part of a business, the seller and buyer may be able to jointly elect to allow for the transfer to occur free of GST/HST (if the conditions of section 167 of the Canada Excise Tax Act are met).

A clearance certificate may be required for bulk sales of assets in certain provinces. The acquisition of real property also generally gives rise to provincial (and sometimes municipal) land transfer tax or fees in most provinces. Rates vary by province (or municipality) and may in some cases apply to the transfer of unregistered (beneficial) ownership or long-term leases.

Disadvantages

Favorable tax attributes of the target corporation will normally be lost in an asset acquisition. An asset acquisition is also more complex than a share acquisition because all assets must be transferred individually. An asset acquisition will generally trigger "anti-assignment" clauses in the target's key contracts, licenses and permits, necessitating third-party consents for the transfer of certain valuable assets of the target. Such consents may not be obtainable or may be obtainable only at a significant price or after long delays. However, it is not usually difficult to obtain consents from public or private parties merely because the ultimate buyer is a non-Canadian person.

Acquisition structures: amalgamations, plans of arrangement and takeover bids

In Canada, amalgamations and plans of arrangement are the primary merger structures for private companies (although an amalgamation is more common in the private company context). Both require a target shareholders' meeting and supermajority approval of the transaction (66 2/3% of the votes cast). Plans of arrangement also require court supervision. Public companies (which offer securities to the public) may also be acquired by these methods (although a plan of arrangement is more common in the public company context) or by way of a takeover bid. In addition to requirements imposed by corporate statute governing the target, a buyer of a public company target, which is a Canadian reporting issuer, must comply with the securities laws of the province or territory (jurisdiction) where the shareholders reside and with the rules of the stock exchange where the target's shares are listed.

Amalgamations

Amalgamations are statutory mergers effected by filing articles of amalgamation. Generally, amalgamations under Canadian corporate law result in each of the amalgamating corporations continuing in the amalgamated corporation. The amalgamating corporations cease to exist (as entities separate from the amalgamated corporation), and the amalgamated corporation possesses all the property and is subject to all the liabilities of each amalgamating corporation.

To be effective, an amalgamation requires the consent of the board of directors and shareholders and a public filing of articles of amalgamation in the relevant jurisdiction. There is usually an amalgamation agreement to record the respective rights, obligations and liabilities of the parties involved in an amalgamation transaction. A notice of meeting containing disclosure sufficient to allow shareholders to make an informed decision must be delivered to shareholders entitled to vote on the amalgamation. (If the amalgamation involves a public company, the notice of meeting will be accompanied by an information circular that will contain very detailed information regarding the transaction and the amalgamating entities, including financial statement disclosure).

The target entity may also be the survivor, often termed a reverse takeover. In this case, it is still possible to eliminate the target's shareholders by automatically converting their shares to cash or to shares in the buyer or another corporation.

Plans of arrangement

Plans of arrangement are statutory mergers effected by filing articles of arrangement. A plan of arrangement is a very flexible way to structure an acquisition and can be used to deal with complex tax issues; to amend the terms of outstanding securities (e.g., convertibles, options, warrants or debentures); and to assign different rights to different holders of securities. Plans of arrangement are also often used when a non-Canadian buyer wants to use its own securities as consideration. Plans of arrangement have the additional benefit of being eligible for an exemption from the SEC's registration and disclosure requirements for securities of a public company that the buyer offers as consideration.

Plans of arrangement are court-supervised, requiring interim court approval and, following approval by the target's shareholders, final court approval. The parties will enter into an arrangement agreement to record the respective rights, obligations and liabilities of the parties, and information similar to that required for an amalgamation must also be delivered to shareholders entitled to vote on an arrangement.

Takeover bids

Takeover bids are the Canadian equivalent to US tender offers. A takeover bid is an offer to acquire outstanding voting or equity securities of a class made to shareholders of the target, where the securities subject to the offer, together with the offeror's existing holdings, constitute 20% or more of the outstanding securities of that class. Existing holdings include securities held by any person or company deemed to be "acting jointly or in concert" with the offeror. Subject to certain exemptions, the bid must be made to all Canadian holders of securities of the class subject to the bid and delivered to holders of securities that may be converted into securities of that class before the expiry of the bid. The bid must remain open for a minimum of 105 days (but may be reduced to no less than 35 days under certain circumstances), and the offeror is required to comply with other technical aspects of the Canadian takeover bid regime.

If at least 90% of the shares of the target are tendered to the bid (other than shares held by or on behalf of the offeror, or its affiliates or associates), an offeror may, within 120 days thereafter, take steps to acquire the remaining shares of the target by resorting to the "compulsory acquisition" provisions found in corporate statutes. If less than 90% but more than 662/3% of the shares are acquired, the offeror can generally proceed with a second stage squeeze-out transaction.

Advantages

The principal advantage of a merger by way of an amalgamation or plan of arrangement is that the transfer of assets and the exchange of target corporation shares are automatic. Shareholders of the target corporation have no option to retain their shares (although dissenting shareholders may have the statutory or court-imposed right to obtain an appraisal of their shares and recover the fair value for the shares in lieu of the amount offered to them in the merger). No separate transfer documents are required.

Valuable permits, contracts and the like may also be easier to transfer in a merger than in an asset sale, but these do not remain in the same corporate entity unless the merger is accomplished through a reverse merger.

Tax deferred rollovers are available for certain qualifying amalgamations.

Disadvantages

A merger by way of an amalgamation or plan of arrangement with a publicly held corporation may be time-consuming because of the need to hold a shareholders' meeting and to comply with other Canadian corporate and securities laws. If the publicly held target is attractive to other potential bidders, the delay in effecting a merger may allow these other bidders to compete for the target, increasing the price of the shares and, possibly, frustrating the acquisition. While contested takeovers have become more common in Europe in recent years, non-Canadian clients are often reluctant to battle, or even compete, with other bidders for Canadian targets. In such cases, a friendly takeover bid for sufficient shares to approve a subsequent merger may be effective. This process may be completed more quickly. If the takeover bid is successful, any remaining shareholders can be eliminated through a "cash out" compulsory acquisition merger of the acquisition vehicle with the target.

An unsolicited acquisition would need to be carried out by way of a takeover bid.

Post-acquisition integration

The Canadian M&A market is sophisticated overall and is accustomed to pre-acquisition due diligence on matters such as bank signatory authority, IT integration, branding matters, employment matters, post-closing tax planning and other post-acquisition integration concerns that drive value.

Common deal structures

What are the key private M&A deal structures?

In Canada, a business can be purchased either by way of a share purchase, an asset purchase or a merger.

The target may use a controlled auction process to solicit potential buyers, but the board of directors is expected to act in the best interests of the corporation, and courts will usually defer to the reasonable business judgment of the board of directors.

Typically, a share sale is less complex than an asset sale, because in a share sale the company's assets, employees, contracts, etc., remain with the company.

In Canada, amalgamations and plans of arrangement are the primary merger structures. Both require a target shareholders' meeting and supermajority approval of the transaction (66.67% of the votes cast). Plans of arrangement also require court supervision.

Amalgamations are statutory mergers effected by filing articles of amalgamation. In general, amalgamations under Canadian corporate law result in each of the amalgamating corporations continuing in the amalgamated corporation. The amalgamating corporations cease to exist (as entities separate from the amalgamated corporation) and the amalgamated corporation possesses all the property and is subject to all the liabilities of each amalgamating corporation. There is usually an amalgamation agreement to record the respective rights, obligations and liabilities of the parties involved in an amalgamation transaction. A notice of meeting containing disclosure sufficient to allow shareholders to make an informed decision must be delivered to shareholders entitled to vote on the amalgamation.

Plans of arrangement are statutory mergers effected by filing articles of arrangement. A plan of arrangement is a very flexible way to structure an acquisition and can be used to deal with complex tax issues, to amend the terms of outstanding securities (e.g., convertibles, options, warrants or debentures) and to assign different rights to different holders of securities. Plans of arrangement are also often used when a non-Canadian acquirer wants to use its own securities as consideration. Plans of arrangement have the additional benefit of being eligible for an exemption from the SEC's registration and disclosure requirements for securities that the acquirer offers as consideration. Plans of arrangement are court-supervised, requiring interim court approval and, following approval by the target's shareholders, final court approval. The parties will enter into an arrangement agreement to record the respective rights, obligations and liabilities of the parties, and information similar to that required for an amalgamation must also be delivered to shareholders entitled to vote on an arrangement.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

Private companies are typically limited companies. It is typical for the articles of a private company to provide that the authorized capital consists of an unlimited number of shares. The Canada Business Corporations Act confers all powers of a natural person on a corporation. There is no requirement under the laws of any jurisdiction in Canada for a minimum paid-in capital.

What are the different types of limited liability companies?

Limited companies may be private or closely held non-offering corporations or corporations offering securities to the public (offering corporations). The articles of a non-offering corporation/private company may contain restrictions on transfers of securities and may prohibit the offering of securities to the public or to more than 50 shareholders (excluding certain employees); however, those restrictions can be removed with the approval of the shareholders. This generally only happens where a company is undertaking, or planning to undertake, an initial public offering or other transaction that results in its securities being publicly traded.

Is there a restriction on shareholder numbers?

A "private issuer" must be beneficially owned by no more than 50 persons, not including employees and former employees of the company or its affiliates. Each person is counted as one beneficial owner unless the person is created or used solely to purchase or hold securities of the company, in which case each beneficial owner or beneficiary must be counted as a separate owner. There is no requirement that a private company be a private issuer; however, private issuers benefit from expanded prospectus exemptions available under securities laws.

What are the key features of a share sale and purchase?

Generally, all that is required to transfer legal title to the shares in a Canadian non-offering corporation is for a stock transfer form to be executed by the seller and then registered in the register of shareholders of the relevant corporation. Depending on the restrictions contained in the corporation's articles, prior approval by the corporation's board of directors and/or shareholders may also be required. A share purchase agreement is usually prepared to record the agreement of the parties on their respective rights, obligations and liabilities in connection with the transaction.

What are the key features of an asset sale and purchase?

When a business is being transferred by way of an asset purchase, each individual asset needs to be transferred in accordance with the formalities for a transfer that applies to that type of asset. For some assets, this will simply be a case of delivering the asset to the buyer, but in other cases, the formalities are more prescriptive, such as in the case of real property or intellectual property. It is, therefore, necessary to include a provision, either in the purchase agreement governing the purchase of the business and its assets or in separate agreements, for the relevant formalities to be complied with. As with a share acquisition, there is usually an asset purchase agreement to record the respective rights, obligations and liabilities of the parties.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

Generally, the parties will enter into a letter of intent that sets out the principal terms of the proposed transaction and contains provisions dealing with confidentiality, an exclusivity period, expense allocations (and reimbursement if the transaction does not close) and a due date for entering into a definitive transaction agreement. Usually, such letters are non-binding (and should be stated as such, if applicable) although provisions relating, for example, to confidentiality, reimbursement of expenses and exclusivity are typically binding. The parties should take care to ensure that the letter clearly discloses the relevant provisions that are or are not binding.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: There is no consistent market practice. Exclusivity provisions can either be found in the term sheet or letter of intent. In some instances they are included as a standalone exclusivity agreement or as part of a non-disclosure agreement.
- Break fee: Not common in private company transactions.
- Confidentiality: Typically included in the term sheet or letter of intent if not included in a standalone non-disclosure agreement.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

It is common to negotiate confidentiality and exclusivity agreements and sometimes they are combined.

Is there a duty or obligation to negotiate in good faith?

There is no general duty to act in good faith when negotiating. However, the Supreme Court of Canada has recognized that parties have a duty of honesty in contractual performance. The parties must not lie or knowingly mislead each other about matters linked to performance of a contract. There is also a line of cases that suggest that a duty to negotiate in good faith may arise in situations where a dominant party uses its superior position to put a vulnerable party in a situation where it is compelled to sign an agreement without the opportunity to fully review or consider it.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: fairly common; purchase price adjustments are common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: working capital adjustments are most prevalent. Other adjustment metrics, including assets, cash and debt are fairly common. Purchase price adjustments may be based on more than one metric.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: it is usually prepared by the buyer; however, it is becoming increasingly common for the seller to prepare it.

Is the balance sheet audited (where applicable)?

Frequency/market practice: not necessarily.

Is an earn-out common?

Frequency/market practice: rarely used. The majority of transactions do not include an earn-out.

Is a deposit common?

Frequency/market practice: rare; not common.

Is an escrow common?

Frequency/market practice: an escrow is fairly common but often there is not a separate escrow for price adjustments and indemnity claims.

Is a break fee common?

Frequency/market practice: rarely; break fees are prominent in public target transactions but not common in private target transactions.

Conditions precedent

Is there an express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common.

Is the MAE general or specific?

Frequency/market practice: the MAE definition is typically general and tends to be forward-looking, but will often contain carve-outs.

Is the MAE quantified?

Frequency/market practice: rarely.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: blue pencil severance is only available where the portion being removed is trivial and is not central to the provision; otherwise it is rarely used.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common.

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common.

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: fairly common.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: fairly common; accuracy of representations at closing is a common condition precedent. Obligation of target to notify buyer of breaches is also common. A covenant requiring or permitting the target to update disclosure schedules is uncommon but not unusual. The consequences of breach are specific to the transaction and any indemnity provisions.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are common, and different materiality thresholds may be used for different representations. Materiality is not typically quantified by an amount.

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge is commonly qualified as constructive knowledge (imposing obligations to conduct an express investigation, reasonable or due inquiry). Specific individuals are usually identified.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: full disclosure representations (no untrue statements and no omissions) and/or US-style '10b-5' representations are not included in the majority of transactions but are not uncommon.

Is disclosure of the data room common?

Frequency/market practice: rarely.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: common to repeat warranties at completion.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: rarely and not at all common, but purchasers often have the right to terminate the agreement for a breach of a representation that would lead to a closing condition not being met.

Is a bring-down certificate at closing common?

Frequency/market practice: a bring-down certificate from seller at completion is common and may be a condition of closing.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: accurate 'in all material respects' is most common and material adverse effect is less common but also a recognized standard. A combination of materiality standards, where different representations are subject to different materiality qualifications, is also common.

Is double materiality common (a materiality qualification in bring-down at closing and in representation(s))?

Frequency/market practice: not common.

Limitations on liability

What is the common cap amount (as a percentage of the purchase price)?

Frequency/market practice: cap amounts range from less than 10% to 100% of the purchase price. It is most common to have a cap between 15% and 50% of the purchase price, but also not uncommon for a cap of 100% of the Purchase Price.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: fairly common; caps commonly apply to indemnification obligations in the entire agreement. Other limitations on liabilities (including baskets) can also be imposed for breach of representations and warranties, breach of seller covenants and other items.

What are the common exceptions to the cap?

Frequency/market practice: common carve-outs for caps can include fraud, due authority, due organization, taxes, ownership of shares, capitalization, intentional breach of representations, no conflict, title to assets, willful misconduct/breach of representations, breach of covenants, broker's fees and environmental representations.

Is a deductible or basket common?

Frequency/market practice: very common; inclusion of a basket is very common and most deals will include one. 'First Dollar' baskets remain most prevalent, but deductible baskets are also common.

Is a de minimis common?

Frequency/market practice: not common; an eligible claim threshold establishing a de minimis amount for any individual claim is usually included in 35-40% of the deals.

How long does seller liability survive?

Frequency/market practice: a range between 12-24 months is most common, with 18 months being most prevalent.

Are there any common carve-outs from limitations on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: carve-outs will often be made for fraud, due authority, due organization, taxes, ownership of shares, capitalization, intentional breach of representations, no conflict, title to assets, willful misconduct/breach of representations, breach of covenants, broker's fees and environmental representations.

Is warranty insurance common?

Frequency/market practice: not common, but use of representation and warranty insurance is increasing.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: this is expressly included in approximately 50% of private target transactions.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: common.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: fairly common; duty to mitigate exists at common law for contractual breaches.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: rarely; 'anti-sandbagging' provisions (no party is liable if the party seeking indemnification had knowledge) are rarely included.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: jurisdiction is usually related to the location of the parties. Where silent, the governing law depends on a number of factors, including the jurisdiction in which the agreement was signed.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: litigation is generally more common; however, alternative dispute resolution provisions are included in approximately one quarter of deals. Where those provisions were included, binding arbitration is predominant.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: no stamp duty in Canada.

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: fairly common; tax covenants included to address the preparation and filing of post-closing taxes. A specific tax indemnity is common.

COVID-19

The coronavirus outbreak (COVID-19) as of the date of this writing impacts the way private M&A transactions are and will be conducted. Providers of representation and warranty insurance will seek to expand exclusions due to potential losses associated with COVID-19. Representations and warranties, including the definitions of MAE, must be carefully considered in light of the possibility that COVID-19 and related consequences could result in termination of the acquisition agreement. The buyer will have to adapt its due diligence appropriately and consider the future viability of certain business lines. There may be delays in obtaining third-party consents and regulatory or government approvals. Buyers will have to carefully ensure that purchase price adjustments and escrow release conditions reflect the potential impact of COVID-19 on the earnings expectations of the seller's business. Furthermore, buyers will need to more carefully consider interim period covenants.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Chile

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

There are no particular issues that a foreign investor should be aware of when undertaking a due diligence review with respect to a Chilean entity or group of assets, other than those usually reviewed, such as property titles, regulatory, tax, labor and social security compliance, permits, corporate structure and powers, material contracts, change of control provisions, compliance matters and environmental matters. Further, merger control from an antitrust perspective should be considered and analyzed.

When issues are found during the due diligence process, it is common to ask the seller to rectify the issue before closing. It is also common for the buyer to seek protection through a reduction in or retention of the purchase price; the buyer may also obtain a special indemnity for a specific contingency.

Foreign exchange control

Chile does not have exchange controls. Certain foreign exchange transactions, such as the ones listed below, should be conducted through the Formal Exchange Market (e.g., through a commercial bank) and reported to the Central Bank of Chile. These transactions include:

- investments, deposits and loans made abroad by Chilean resident individuals in excess of USD 10,000; or
- capital contributions, investments, deposits and loans made from abroad into Chile in excess of USD 10,000.

Funds invested in Chile through the Formal Exchange Market may be repatriated abroad at any time, as well as the profits arising from those investments.

Signing/closing

Deposits are not required, but both deposits and escrow arrangements are fairly common in the cases of both share and asset deals.

In small deals, simultaneous signing and closing is common in the cases of both share and asset deals. Whether signing and closing is simultaneous or non-simultaneous will depend on whether there are conditions that must be satisfied, including regulatory approvals (e.g., merger control), divestments or spin-offs of certain parts of the target entity (e.g., affiliates, business lines, groups of assets), third-party consents/waivers, drawdown of funds, or the resolution of issues discovered during due diligence.

Approvals/registrations

Foreign investment

Chilean laws are structured to encourage foreign investment by providing a stable and certain regulatory framework that allows foreign investors to compete on equal terms with local businesses and entrepreneurs. With the exception of certain industries which must have Chilean ownership to protect national interests (e.g., fisheries), 100% foreign ownership of investments is possible. As a general rule, Chilean law does not require investors to obtain any foreign investment permits or licenses other than for specific industry sectors (e.g., insurance, banking and telecoms).

Setting up a new company in Chile is a simple, cheap and straightforward process that usually takes around two weeks or less.

Merger control

All entities participating in a transaction that produces effects in Chile and results in a party acquiring control or decisive influence must jointly notify and consult with the antitrust authority (*Fiscalia Nacional Económica*, or FNE) before consummation of the transaction if the following conditions are met:

- the total amount of the sales in Chile of all participating entities is equal to or higher than CLF 2.5 million (approximately USD 100.7 million) during the year prior to that in which the notification is verified; and
- at least two of the participating entities have each generated individual sales in Chile higher than CLF 450,000 (approximately USD 18.1 million) during the year prior to that in which the notification is verified.

Transactions that do not meet the above thresholds may still voluntarily notify the FNE.

Other regulatory or government approvals

Approval by the corresponding regulator (superintendence or the Commission for the Financial Market) or government entity is required for acquisitions of certain regulated entities, including banks, insurance companies, investment and pension funds, and public works concession companies.

Employment

Under the Chilean Labor Code, the decision of how to manage the business is reserved to the employer. The employer is allowed to sell the business through a share or asset sale, sell a section of the business, merge, or divide the business or carry out any other form of corporate transaction. Employees have no say in the decision. There is no obligation to obtain consent from, or report to, employees or labor unions or even the labor authority. However, employees are not left to their own devices. The law affords employees a protection known as the labor continuity rule.

Under the labor continuity rule, the total or partial change of ownership, possession or occupation of a business does not alter the rights and obligations of the employees arising out of their individual employee agreements or collective instruments. These remain in force and effect under the new employer.

In practical terms, the new employer will inherit the employees with all of their then current rights and obligations, including seniority. If the new employer wishes to change any terms and conditions of the employment agreements because, for example, they contradict the new employer's policies, any such changes will require the consent of the employees.

In the event that there is a change of ownership that qualifies as labor continuity, there is no need to terminate the employment agreement and, consequently, no need to pay severance or any of the other termination obligations. Labor continuity applies as a matter of law and no further formality is required. However, it is recommended to subscribe an addendum with each employee indicating the change of ownership and the name of the new employer.

Tax

No stamp or registration or any other similar taxes or charges are payable under the laws of Chile in connection with the execution, delivery, performance or enforcement of an asset or share acquisition. In the case of a share sale, the names and tax IDs of the new shareholders of the target entity must be provided to the Chilean Internal Revenue Service within 15 days from the acquisition.

The acquisition of assets is not subject to transfer taxes or any other similar taxes. However, the sale of used vehicles is subject to a municipal tax of 1.5% of the purchase price or the fiscal valuation of the vehicle, whichever is higher. This municipal tax must be borne by the buyer.

The sale of inventory of a Chilean company will be subject to VAT at a rate of 19%. The sale of fixed assets, including vehicles, is subject to VAT at a rate of 19% only if the seller is entitled to a fiscal VAT credit upon acquisition of such asset. Fixed assets and vehicles must also be detailed in the corresponding Chilean invoices.

Post-acquisition integration

Integration between the buyer and target or group of assets is usually a straightforward process. However, the structure of the integration, particularly in the case of mergers, may have tax and labor implications.

Alternative corporate structures are available to merge or consolidate companies in Chile, with different rules applying to the different investment vehicles. Mergers between different types of companies are allowed. There are two main types of mergers in Chile: statutory and non-statutory. In a statutory merger, a resolution approving the merger (as well as certain other materials supporting the merger) must be adopted at a special shareholders' meeting. For each of the entities involved in the merger, the resolution must carry a supermajority vote of at least two-thirds of the shares entitled to vote in the case of stock companies (*sociedades anónimas*) or the quorum established in the bylaws, if different, in the case of companies by shares (*sociedades por acciones*). Dissenting shareholders will have the right to require the corporation to buy their shares (withdrawal right) at net book value in the case of private/closed corporations and market value in the case of public/open corporations. The bylaws of stock companies may eliminate the withdrawal rights, however.

Although it is not expressly regulated, Chilean law also allows for a statutory merger of a limited liability company (*sociedad de responsabilidad limitada*) that requires the unanimous consent of all quota holders.

A non-statutory merger is achieved when 100% of the shares/quota rights in a corporation or limited liability company, respectively, are held by one sole shareholder/partner. The same rule may also apply to a stock company as long as its bylaws expressly allow for this.

As a general rule, mergers proceed by cancelling the shares/quota rights of the "absorbed" company, transferring the absorbed company's assets and liabilities to the "absorbing" company, issuing shares/increasing the capital in the absorbing company, and giving those shares/interests to the shareholders/quota holders of the absorbed company.

Normally, tax benefits such as accrued losses cannot be transferred from the absorbed company to the absorbing company, but tax effects must be determined on a case-by-case basis. No stamp or registration or any other similar taxes or charges are payable under the laws of Chile in connection with the execution of a merger.

If the buyer intends to make any employees of the target business/company redundant, it should carefully consider the employees' rights to statutory compensation and protection against dismissal.

Certain employees, such as union representatives, pregnant women and employees on sick or family leave, enjoy special protection against dismissal (their employment contracts cannot be terminated on the grounds of business necessity or "at will"). In these cases, the employer may not terminate the employment contract without the prior approval of the labor court. However, such permission will not be granted in cases of termination on the grounds of business necessity or "at will."

The employment contracts of union representatives, non-union employees' representatives and employees' representatives on safety committees may be terminated without the labor court's prior approval only when the closure of a business involves the dissolution of the entire company.

Common deal structures

What are the key private M&A deal structures?

The main types of corporate structures are: (1) limited liability companies/partnerships (*Sociedades de Responsabilidad Limitada/Ltdas*); (2) stock corporations (*Sociedades Anónimas*/S.A.); and (3) companies by shares (*Sociedades por Acciones*/SpA). SpAs have become one of the most common vehicles to structure a business in Chile. They afford shareholders flexibility in terms of structuring the company's management and they are the only legal entity in Chile that permits only one shareholder. Furthermore, these types of entities were designed to facilitate venture capital and private equity.

A business can be acquired either by way of a share purchase (or 'quotas,' in the case of an Ltda) or an asset purchase. Alternative structures are mergers or consolidate companies.

Auction processes are more and more common now, particularly for sophisticated sellers who want to control the sale process and to optimize the purchase price.

Bid process letters are used and it is common to use indicative bid letters that are non-binding during the first stage. The seller or its investment banker typically selects the best offers and then requires those bidders to submit a binding final offer.

The auction process typically proceeds as follows: (i) the seller or its banker sends an information memorandum to a list of potential bidders requesting an indicative offer within a certain timeframe; (ii) bidders submit indicative offers; (iii) the seller or investment banker selects the best offers and invites those selected bidders to conduct a due diligence within a determined timeframe (normally a virtual data room); (iv) the selected bidders are required to present a binding offer and a markup of a share purchase agreement previously provided by the seller; and (v) the seller selects the final buyer which is called to sign the share purchase agreement (signing and closing may take place separately or simultaneously, depending upon the transaction).

There are two main types of mergers in Chile: statutory and non-statutory mergers. Mergers between different types of companies are allowed. As a general rule, mergers proceed by cancelling the shares/quotas of the "absorbed" company, transferring the absorbed company's assets and liabilities to the "absorbing" one, issuing shares/increasing the capital of the absorbing company and transferring the shares/quotas to the shareholders/partners of the absorbed company.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

The *Sociedad de Responsabilidad Limitada* ("**SRL**") and the *Sociedad por Acciones* ("**SpA**") are the most commonly used business entities in Chile.

What are the different types of limited liability companies?

There are three types of limited liability companies: (1) limited liability companies/partnerships (*Sociedades de Responsabilidad Limitada*/SRL); (2) stock corporations (*Sociedades Anónimas*/SA); and (3) companies by shares (*Sociedades por Acciones*/SpA).

Is there a restriction on shareholder numbers?

Limited liability companies (*Sociedades de Responsabilidad Limitada*/SRL) must have at least two quotaholders and a maximum of 50 quotaholders. Stock corporations (*Sociedades Anónimas*/SA) must have a minimum of two shareholders and there is no limit on the total number of shareholders. Companies by shares (*Sociedades por Acciones*/SpA) may have only one shareholder and there is no limit on the number of shareholders.

What are the key features of a share sale and purchase?

Generally, all that is required to transfer the shares in an SA or an SpA is a private share transfer form or a public deed executed by both seller and buyer (in compliance with certain mandatory formalities as set out in the regulations to the Stock Corporations Law), followed by registration in the shareholders' registry of the company. A share certificate may or may not be issued, at the option of the new shareholder. A share purchase agreement is usually prepared to record the agreement of the parties with respect to their respective rights, obligations and liabilities in connection with the transaction.

What are the key features of an asset sale and purchase?

When a business is being transferred via an asset purchase, each individual asset needs to be transferred in accordance with the formalities for a transfer that apply to that type of asset. For some assets, this will simply be a case of delivering the asset to the buyer, but in other cases, the formalities are more prescriptive, as in cases with assets that are subject to registration (e.g., real estate, intellectual property, motor vehicles or mining concessions). It will therefore be necessary to record the agreement in a public deed or to include a provision, in the purchase agreement governing the purchase of the business and its assets or in separate agreements, for the relevant formalities to be complied with. As with a share acquisition, there is usually an asset purchase agreement to record the respective rights, obligations and liabilities of the parties in connection with the transaction.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

It is quite common to prepare a letter of intent or term sheet. They normally are non-binding, except for certain binding provisions such as confidentiality, exclusivity (if allowed), access to due diligence, costs and expenses, dispute resolution and applicable law.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: It is common to include provisions on exclusivity;
- Break fee: Break fees are included in very limited circumstances;
- Confidentiality: It is common to include provisions on confidentiality.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Exclusivity and break fees are normally part of the letter of intent or term sheet. Confidentiality agreements are sometimes negotiated separately.

Is there a duty or obligation to negotiate in good faith?

Chilean law expressly establishes a duty or obligation to act in good faith and breach thereof may result in pre-contractual liability.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: purchase price adjustments are fairly common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: all types are seen, including working capital adjustment, cash-free debt-free, NAV adjustments, earn-out adjustments and others.

Is there a collar on the purchase price adjustment?

Frequency/market practice: collars are rarely seen.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually the buyer, but sometimes the target company.

Is the balance sheet audited (where applicable)?

Frequency/market practice: not necessarily, although it is generally seen in practice.

Is an earn-out common?

Frequency/market practice: not very common; it is more common in private equity transactions where sellers continue to manage the target company after closing, but also in M&A transactions. It is less common where the seller is completely exiting.

Is a deposit common?

Frequency/market practice: rarely seen.

Is an escrow common?

Frequency/market practice: fairly common.

Is a break fee common?

Frequency/market practice: rarely seen.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common.

Is the MAE general or specific?

Frequency/market practice: normally specific.

Is the MAE quantified?

Frequency/market practice: quantifying the MAE is fairly common.

Covenants

Is a non-compete common?

Frequency/market practice: very common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: blue pencil provisions are very common (and will apply if the agreement is silent and subject to Chilean law).

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common.

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common.

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: fairly common; it is common to update disclosure schedules, but normally limited to things like lists of contracts. Notification of possible breach is common. In cases of material breach, there is usually a right to adjust the purchase price or to terminate the agreement.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: materiality qualifiers are commonly seen although not usually quantified (except by certain sophisticated sellers).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: all alternatives can be seen, although they are usually limited to actual knowledge and due enquiry of a specified list of senior management.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: this is fairly common, but sophisticated sellers try to avoid it.

Is disclosure of the data room common?

Frequency/market practice: fairly common; this is generally resisted, except in auctions.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: repetition at closing is fairly common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: fairly common.

Is a bring-down certificate at closing common?

Frequency/market practice: fairly common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate in all material respects is common but often carve out for some fundamental representations, which must be absolutely clean and true.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely seen; double materiality is usually avoided.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: this depends on the type of deal and the industry of the target. In general, the buyer will ask for 100% but it is possible to negotiate down. It ranges from 10% to 100% (mostly less than 100%).

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: both are seen regularly, but it depends on the sophistication of the parties (most commonly applies to the whole agreement, except for fundamental warranties and cases of fraud or gross negligence).

What are the common exceptions to the cap?

Frequency/market practice: key or fundamental warranties are often excepted (e.g., title, capitalization, authority). Often tax, labor, environmental and specific areas of concern, sometimes with specific higher caps. Separate caps can be negotiated. Normally gross negligence and willful misconduct are also excluded.

Is a deductible or basket common?

Frequency/market practice: both are fairly common.

Is a de minimis common?

Frequency/market practice: fairly common

How long does seller liability survive?

Frequency/market practice: a general survival of 18-24 months is common.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: it is common to carve out labor, tax, environmental and some specific areas of concern. Gross negligence and willful misconduct are excluded by law.

Is warranty insurance common?

Frequency/market practice: rarely seen, although available in Chile and now seen more in certain transactions.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: rarely seen.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common; increasingly common for actually received proceeds.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common; increasingly common for actually received recoveries.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: fairly common.

Is there an exclusion of consequential damages?

Frequency/market practice: very common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: such provisions are rarely seen.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes, but subject to Chilean public policy rules.

What is the common governing law?

Frequency/market practice: common governing law is Chilean law. Only in limited cases do parties agree on a foreign law.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is more common. The Santiago Chamber of Commerce is normally appointed, or alternatively the ICC in Paris or Madrid or the AAA in Miami.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: no stamp duty is payable.

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: it is fairly common to have tax indemnity, usually included in the purchase agreement.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Colombia

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

In Colombia, regulatory non-compliance is not uncommon, particularly when the target is a family-owned business. Examples of non-compliance include underpayment of social insurance or violation of overtime policies for employees, as well as breaches of tax law, data privacy law and environmental law. Often such non-compliance means additional costs for rectification and operations post-closing.

As these issues may erode deal value, a thorough due diligence process is recommended in order to define a plan for both the negotiation of the agreement and post-closing. A deep understanding of the local practice and practical risks involved is required to create an appropriate solution. It may be advisable to seek protection through a reduction in or retention of the purchase price. Escrow arrangements are also increasingly common in Colombia.

Pricing and payment

There are no special considerations regarding pricing and payment in Colombia. Parties may freely negotiate the terms taking into account foreign exchange controls (see below) and antitrust and other governmental authorizations (see below).

Foreign exchange control

Colombia has a floating exchange regime that operates as part of a wider economic policy targeting inflation. The Colombian Central Bank monitors currency flows and purchases foreign currency to ensure stability, but in general does not restrict the free-flowing exchange market. While businesses are not restricted from moving foreign currency into or out of the country in principle, they are required to comply with the related reporting and regulatory requirements.

The general rule is that payments for goods or services between Colombian companies or individual residents must be made in Colombian pesos. This means that foreign investors will frequently need to exchange foreign currency into Colombian pesos to make payments and conduct business in the country. Exceptions to this rule include payments made from offshore accounts registered with the Central Bank and payments with respect to certain companies in the oil, gas and mining sectors.

Most business transactions that require an exchange of foreign currency into pesos (or vice versa) are regulated and the exchange must be made through an authorized channel, such as a foreign exchange market intermediary (i.e., financial entity).

Signing/closing

A deposit is not required, nor is it common, in Colombia. Whether signing and closing is simultaneous or non-simultaneous will depend on the conditions of each transaction. Both mechanisms are common.

Approvals/registrations

Foreign investment

Pursuant to the constitution and foreign investment regulations, foreign investment in Colombia receives the same treatment as investments made by Colombian nationals. The conditions for reimbursement of foreign investment and remittance of profits in effect at the time the investment is registered may not be changed so as to adversely affect foreign investment except on a temporary basis when the international reserves are lower than the value of three months' worth of imports.

Any investment made by a person that does not qualify as a resident of Colombia for foreign exchange purposes will qualify as a foreign investment. Such investments must be registered with the Colombian Central Bank.

Merger control

Any transaction resulting in an economic concentration in at least one market in Colombia involving two or more entities that are engaged in the same economic activity, or the same line of production or distribution with respect to a final product or service that is sold in Colombia, will be subject to Colombian merger control. An economic concentration involving local or foreign entities will be subject to merger control clearance if the transaction directly or indirectly (through distributors or imports) affects the Colombian market. Likewise, economic concentrations outside of Colombia that affect the Colombian market directly or indirectly may be subject to prior notification and clearance by the Superintendence of Industry and Commerce ("**SIC**").

All parties involved must inform the SIC and obtain prior approval to confirm that the transaction meets the following criteria:

- Subjective criterion: triggered if the transaction has the effect of concentrating one or more markets in Colombia. This occurs either when two or more parties to the transaction are involved in the same activity (horizontal effects) or when the transaction has the potential to create vertical links in one or more markets in Colombia (i.e., when the parties are part of different links in a production chain), regardless of the legal structure used; and
- Objective criterion: triggered when all parties involved in the transaction (not only Colombian entities) report a combined value that exceeds legal thresholds on operational turnover or total assets as established annually by the SIC (approximately USD 14 million for 2020).

This control is exercised by the SIC regardless of the legal structure of the transaction through which the parties achieve the consolidation, merger or integration. The SIC may authorize the transaction (either unconditionally or subject to certain commitments or remedies) or reject the transaction.

When the combined market share of the parties is below 20% in all of the markets potentially affected, a simplified notification procedure and a fast-track approval process is available. In these cases, the transaction will be deemed to be approved upon the filing of a notice.

On average, antitrust clearance can take between two and eight months, unless the transaction triggers a risk of undue restriction of free competition, in which case the procedures can take longer.

Other regulatory or government approvals

For acquisitions in certain sectors, such as the financial industry, private surveillance and security services, telecommunications, and healthcare, approval from the relevant industry regulator is required.

For mergers, administrative authorizations may be required if any of the merging companies are subject to government oversight (i.e., by the Financial Superintendence or the Superintendence of Companies) or meet certain conditions, such as having liabilities on their balance sheet or having registered goodwill - pending amortization.

Upon authorization from the relevant authority, if required, the companies must incorporate the agreed-upon merger into a public deed (or into a private document if the absorbing entity is a simplified stock corporation and there is no transfer of real estate), together with the financial statements and other documents related to the merger, and amend the surviving company's bylaws. This must be registered with the Chamber of Commerce and all pertinent notifications to other government entities must be made.

Employment

Share sales: When a business is transferred through a stock purchase, the transaction will not involve a change of employer (employer substitution). Therefore, employee conditions, benefits and entitlements are unaffected. Consent from employees or labor unions is not required for the transfer.

Asset sales: If the transaction is structured as an asset purchase that entails the automatic transfer of personnel, it would be considered an employer substitution if the parties have not previously assigned or terminated the employment agreements. The transfer of personnel by means of an employer substitution would operate automatically, by virtue of law, upon execution of an asset purchase agreement.

The transferred employees will not be legally entitled to refuse the change of employer or to demand payment of any social benefits or redundancy or severance pay due as a result of the employer substitution, as the employment agreement is not terminated, suspended or modified. If they do not wish to work for the new employer, they can resign, as any employee is legally entitled to do.

Tax

Foreign investors that have transferred assets located in Colombia shall file before the Colombian Tax Office an income tax return during the month following closing. For that purpose, the foreign entity or individual shall be registered in Colombia and have a digital signature. No stamp duty applies.

Post-acquisition integration

N/A

Common deal structures

What are the key private M&A deal structures?

Acquiring a business in Colombia may take several forms. What follows summarizes the main legal issues in acquiring an ongoing business by way of the three most common transactions seen in Colombia:

- the purchase of shares;
- the purchase of assets; and
- mergers.

The acquisition of Colombian entities by share purchase may take place through the issuance of new shares or the purchase of existing shares. In both cases, the relevant shareholder approvals will need to be sought in compliance with the company's bylaws. As in many jurisdictions, it is customary for the seller to give the purchaser representations and warranties associated with the company, its business, assets, liabilities and financial position. Parties may also make payment and the transfer of shares conditional on certain events and may limit their responsibility and the amount to which they may be liable in the event of breach of contract. Where new shares are issued, the capital contributions are made to the company and not to its shareholders or partners. Where existing shares are purchased, the payment is made to the selling shareholder.

In Colombia, there are two ways to undertake a transfer of assets: (i) by means of the transfer of the individual assets, or (ii) by means of the transfer of a commercial establishment or ongoing concern. Asset purchases allow the buyer to cherry-pick the assets it requires and only assume the liabilities associated with those assets. While in principle there are no special voting majorities required to dispose of a business as an ongoing concern, the company's bylaws often establish limitations or requirements in this regard. For simplified corporations, the sale of a substantial part of the assets (50% or more of the net equity) grants withdrawal rights to absent or dissenting shareholders. If a business is sold as an ongoing concern, the sale is deemed to take place over the commercial establishment as a single economic unit, without requiring the parties to specify each of the assets. The seller must deliver financial statements for the commercial establishment, listing the liabilities, which must be certified by a public accountant. When the business is transferred as an ongoing concern, notice of the sale must be published in newspapers. Creditors then have two months to oppose the sale and to demand guarantees or security for payment. The sale must then be registered before the Chamber of Commerce. Antitrust clearance may be required. Unlike mergers, governmental authorization is generally not needed.

Mergers must be approved by shareholders (or partners) and can be implemented by the formation of a new company (which will absorb one or more dissolved, not yet liquidated corporations) or by an existing company absorbing another. The surviving company assumes all assets, obligations and liabilities of the absorbed company or companies. Where a company holds more than 90% of the shares of a simplified corporation, a streamlined merger process is available, whereby approval of the general assembly is not required. However, mergers are generally used in Colombia as a reorganization mechanism to simplify corporate structures or to seek tax efficiencies. It is uncommon in Colombia to acquire a non-affiliated company by means of a merger.

Auction processes are often seen in Colombia and are structured in a variety of ways. The most common structure involves an initial bid process letter describing the terms for bidders to submit initial non-binding or indication of interest letters, and a second bid process letter addressed to the bidders selected for the final stage where the final terms of the binding offer are set.

Schemes of arrangement are not generally used as an acquisition method; instead, this procedure aims to preserve companies that are still financially viable through an agreement among creditors. When no agreement is reached or when the insolvent debtor does not fulfill such agreement, a liquidation process will follow. The purpose of the process is to seek a payment agreement so that all claims are included and paid as the insolvent debtor recovers financially. However, as a consequence of COVID-19, recently enacted laws allow creditors, in order to rescue their debtors from a judicial liquidation and maintain their value as an ongoing concern, to acquire 100% of the outstanding capital of the latter by contributing new resources, so long as such resources are used to pay the creditor's debts.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

The four most common corporate structures are the following: (i) simplified corporation (*sociedad por acciones simplificada*), (ii) traditional corporation (*sociedad anónima*), (iii) limited liability company (*sociedad de responsabilidad limitada*) and (iv) the branch of a foreign company.

The most suitable way to carry out business in Colombia is to set up a subsidiary, either a simplified corporation, a corporation or a limited liability company. These entities limit, as a general rule, the liability of the investor to the amount of its contribution (with exceptions for each kind of company). Another way to carry out business is via a branch of a foreign company, which is deemed a commercial establishment of the foreign entity in Colombia.

What are the different types of limited liability companies?

Corporations (*sociedades anónimas*), simplified corporations (*sociedades por acciones simplificada*) and limited liability companies (*sociedades de responsabilidad limitada* or SRL) are the types of companies with limited liability.

In the case of an SRL, the partners are jointly and severally liable for the labor obligations of the company's employees and for all income tax obligations of the company, therefore liability is not entirely limited. As a general rule, the liability of the partners is limited to the amount of their capital contribution, however:

- the bylaws may provide for a greater responsibility of some or all of the partners;
- the partners of a limited liability company are jointly and severally liable for the labor obligations of the company's employees; and
- tax law provides that partners of a limited liability company are jointly and severally liable for all income tax obligations of the company.

The capital of an SRL is divided into quotas of equal value. The capital of the company must be entirely paid-in on its incorporation. Each quota grants each partner one vote. Partners are entitled to transfer their quotas which must be formalized by means of an amendment of its bylaws and, when doing so, all other partners have a statutory right of first refusal in the amount of their existing participation unless the bylaws provide otherwise.

In the case of a corporation or simplified corporation, liability of shareholders is limited to the amount of their respective capital contributions.

Is there a restriction on shareholder numbers?

Corporations are required to have a minimum of five shareholders and a single shareholder cannot hold 95% or more of the total shares.

Simplified corporations can be formed with one or more shareholders.

A minimum of two partners (either individuals or entities) contributing capital is required to form a limited liability company. The maximum number of partners permitted is 25.

In general terms, there are no minimum capital requirements for companies in Colombia, unless the company is in a specific business that requires minimum funding (e.g., financial institutions).

What are the key features of a share sale and purchase?

As a general rule, shares are freely negotiable unless a right of first refusal in favor of the current shareholders is agreed or in the case of simplified corporations when a prohibition on the transfer of shares is incorporated in the bylaws. Partners in a limited liability company have a statutory right of first refusal in the amount of their existing participation unless the bylaws provide otherwise.

Title to shares in a corporation or a simplified corporation is transferred to the buyer from the seller by the agreement of the parties. For the transfer to be effective vis-à-vis third parties and to be formalized, the transfer must be registered by the company in its stock registry (which it will be required to do once it has received the duly endorsed share certificates or a letter from the seller requesting that the operation be recorded). On the other hand, the transfer of quotas in a limited liability company needs to be formalized by means of an amendment to its bylaws duly registered before the Chamber of Commerce.

What are the key features of an asset sale and purchase?

In Colombia, there are two principal ways to undertake a transfer of assets:

- by the transfer of a commercial unit or ongoing concern (commercial establishment), which consists of a group of assets that are destined by an entity to form a separate commercial unit, registered as such before the Chamber of Commerce; certain special procedures and rules will apply to this kind of transfer (including rules regarding liability between the transferee and transferor); and
- by transfer of the individual assets not organized nor registered as a commercial unit before the Chamber of Commerce.

Unless otherwise stipulated, the sale of commercial establishments will be deemed to take place over the commercial establishment as an economic unit without requiring the parties to specify each of the assets being transferred. No special voting majorities are required by law to dispose of a major part of an establishment's assets (although the bylaws do usually establish rules regarding such asset transfers).

In the case of the transfer of individual assets, no special procedure needs to be followed for the transfer of assets. Such transfer will be governed by the asset purchase agreement entered into between the parties. However, note that the formalization of the transfer of assets will need to be undertaken following the rules to transfer each specific asset (e.g., real estate needs to be transferred by means of a public deed and must be appropriately registered).

The following considerations should be taken into account in connection with the transfer of assets:

- Labor liabilities: The entity transferring the assets and the entity receiving such assets will be jointly and several liable for the obligations incurred prior to the transfer of the employees.

- Tax liability: As a general rule, tax liabilities will not be transferred to the entity to which the assets are transferred; only real estate taxes and vehicle taxes would be carried over. For Bogota, some liability may arise to the transferee in local revenue tax ("**ICA**") if the asset deal transaction is structured as a sale of a commercial unit.
- In a simplified corporation, a global transfer of assets shall be considered to have occurred when the proposed transaction is thought to transfer assets and liabilities that represent 50% or more of the liquid assets of the company on the date of the transfer. This transfer must be (i) approved by general assembly with a simple majority vote and (ii) registered before the Chamber of Commerce. Dissenting and absent shareholders will have withdraw rights.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

It is common for companies to enter into separate confidentiality agreements at the outset of negotiations before entering into a more detailed memorandum of understanding or letter of intent as negotiations progress. Such documents frequently contain provisions regarding exclusivity, which are heavily negotiated.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: It is common to include provisions on exclusivity in letters of intent or term sheets.
- Break fee: Break fees are rarely used.
- Confidentiality: It is common to include provisions on confidentiality in letters of intent or term sheets.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

It is more common to enter into separate confidentiality agreements at the outset of negotiations. Exclusivity agreements are not usually common separate agreements, but more as part of letters of intent, term sheets or confidentiality/non-disclosure agreements.

Is there a duty or obligation to negotiate in good faith?

According to the Colombian Commercial Code, in the pre-contractual phase the parties must act in good faith and must pay for any damages caused when they do not comply with this provision. This phase includes several steps that will be taken before the contract is executed, including commercial offers, counter-offers, negotiations and bidding processes. Precedents in Colombia have established several behaviors that will be taken into account to determine if the parties have acted in good faith. The parties:

- must provide accurate and sufficient information—a key factor influencing the decision to execute a contract;
- must not create false expectations about execution of a contract if they know that the contract will not be executed; and
- will be bound by confidentiality obligations regarding the information obtained in a negotiation phase even if a contract is not executed as a result of that process.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: very common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: cash free/debt free and working capital are very common. Depending on where the main value of the transaction is, it is also common to use alternative adjustments, e.g., client portfolio variances, net income results, etc.

Additionally, locked-box mechanisms are also fairly common.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely; collars are not frequently used.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually prepared by the target company.

Is the balance sheet audited (where applicable)?

Frequency/market practice: fairly common.

Is an earn-out common?

Frequency/market practice: rarely. However, earn-out provisions are expected to gain ground in the local M&A practice, given the difficulties of properly valuating companies amid the current economic situation, where the future and potential of several industries is uncertain.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: increasingly common.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common; this is becoming increasingly common, especially where there is a long period between signing and closing.

Is the MAE general or specific?

Frequency/market practice: the MAE definition is usually general and forward-looking, but sometimes includes specific carve-outs.

Is the MAE quantified?

Frequency/market practice: rarely.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common; it is becoming increasingly common to use non-compete covenants due to relaxation of the competition authority's policy on the subject.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: rarely; specific waterfall/blue pencil provisions are not used in non-compete covenants.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common.

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common (in conjunction with a non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: fairly common; care is needed to avoid antitrust gun-jumping concerns.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common, except in concentrated markets (in which case full access is granted only after the competition authority has cleared the transaction or to the 'clean team.' which is an impartial third party bound by strict confidentiality protocols regarding the critical sensitive information submitted by the seller).

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: it is fairly common to provide a bring-down certificate at closing and notify a possible breach, but it is not common to update disclosure schedules at closing.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen but are often not quantified (other than specific warranties, e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers quite common, but usually applicable to specific representations. They are usually limited to actual knowledge after due inquiry of specific individuals.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: rarely; sophisticated sellers try to avoid it and, if pressured, will accept it if limited to fraud or intention to mislead.

Is disclosure of the data room common?

Frequency/market practice: rarely; generally resisted.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: very common by way of a bring-down certificate.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: it is not common to repeat warranties "at all times" between signing and closing. Usually variations of warranties between signing and closing are regulated through covenants of conduct of business between signing and closing which are confirmed by way of a bring-down certificate at closing.

Is a bring-down certificate at closing common?

Frequency/market practice: very common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate in all material respects.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely; double materiality is usually avoided.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: this ranges typically around 15%-30% of the purchase price.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: they usually just apply to misrepresentations and sometimes specific caps to special indemnities.

What are the common exceptions to the cap?

Frequency/market practice: common exceptions include fraud, fundamental representations (e.g., title, capitalization, authority), FCPA or anti-bribery, compliance with covenants and specific indemnities.

Is a deductible or basket common?

Frequency/market practice: fairly common; baskets are becoming widely accepted; deductibles less so.

Is a *de minimis* common?

Frequency/market practice: increasingly common.

How long does seller liability survive?

Frequency/market practice: a general survival of 18-36 months is common.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: fundamental representations, tax and labor are liabilities usually tied to expiration of statute of limitations.

Is warranty insurance common?

Frequency/market practice: rarely.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common; this is becoming more common.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common; this is becoming more common.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common; this is becoming more common.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: rarely.

Is there an exclusion of consequential damages?

Frequency/market practice: very common (although probably unnecessary in most cases as under Colombian law only direct, foreseeable damages are indemnifiable).

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: rarely; the agreement is usually silent on this point. If it is silent, then anti-sandbagging will apply. In principle, the buyer's knowledge works for the benefit of the seller. However, pro- and anti-sandbagging provisions are becoming more common and, when included, are usually heavily negotiated between the parties.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes, if disputes under the agreement are validly referred to international arbitration (which requires a significant connection with a jurisdiction other than Colombia, e.g., a party incorporated abroad). The international arbitral tribunal will decide in accordance with the rules of law chosen by the parties.

What is the common governing law?

Frequency/market practice: aside from Colombian law, New York law is a popular choice.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: domestic arbitration under the Bogota Chamber of Commerce Rules is more common for small and mid-size transactions. In larger deals, arbitration under ICC rules in a venue that is considered neutral is common.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: no stamp duty applies.

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: rarely; it is increasingly common to have a tax indemnity, usually included in the purchase agreement.

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Guide to Navigating Global Private M&A

Czech Republic

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

The due diligence process in the Czech Republic is well established and standardized. Disclosure of documents and information, however, is still very much driven by the seller, and the buyer has limited independent sources from which to confirm issues such as litigation, compliance, environmental exposures and regulatory risks. Post-closing confirmatory due diligence is one of the ways to avoid risks.

It is common to reflect any risks that the buyer is not able to sufficiently verify from other sources (litigation exposure, anti-bribery risks, import/export compliance) into transaction documents, combined with escrow arrangements. Privacy, information security and related matters have arisen recently as issues that require significant attention from the buyer's side.

Independent appraisal

Independent appraisal is generally not required for share deals and for some forms of asset deals. In some more sophisticated transactions (spin-offs, other types of divesting of operational business), independent appraisal reports are required by governmental authorities in order to record the divesting process in the Czech Commercial Register.

Payment

Wire transfers of funds are common and wire transfers through the SWIFT Code international system are also common. Generally, no approval by Czech authorities such as the Ministry of Finance or Czech National Bank is required to make an investment, although, in some cases, simple reporting to the Czech National Bank is required.

Acquisition methods

Share sale

The acquisition of shares or membership interests is generally simpler than asset acquisitions in terms of paperwork and procedural issues.

Where shares are acquired, all assets remain in the target company and few transfer documents are required. Thus, the acquisition may be completed fairly quickly. A share sale does not trigger any transfer tax. Records, if any, are needed only if the share deal requires registration with the Czech Commercial Register, but the process is relatively simple. The target company will retain all of its assets, including its licenses and permits. In addition, unlike in asset acquisitions, third-party consents for the assignment of important contracts and leases will generally not be required, unless they contain change of control clauses.

In a share acquisition, the target company will usually retain its tax attributes, both favorable and unfavorable, assuming that the business is continued. A higher purchase price paid for the business may not be reflected in the tax basis of the target company's assets after the acquisition. The target company will retain all of its liabilities (including tax), whether disclosed or undisclosed. Indemnification for tax (and other) liabilities is frequently part of the transaction.

A share acquisition can also be cumbersome if the buyer does not wish to purchase the target company in its entirety; in that situation, a sale as a "going concern" will be a better fit (see asset sale below). In certain cases, it may be advisable for the target company to be spun off and divided into the wanted and unwanted businesses or assets before a share acquisition. However, both the legal and tax aspects of a demerger (or corporate split) are more complicated in the Czech Republic and take longer (several months or more) to implement.

Asset sale

In an asset acquisition, the buyer acquires specified assets (tangible and intangible) of the target company. However, Czech law is quite restrictive on the ability to acquire liabilities and, frequently, an asset acquisition may only be made with the consent of a third party holding a liability against the target company. Clear identification of the specific assets to be transferred and the specific liabilities to be assumed is critical in an asset acquisition.

In an asset transaction, licenses and official permits are not usually transferable and stay with the original entity. Therefore, the buyer needs to obtain new licenses and permits for its operation, though this can often be achieved quickly. Change of control is frequently triggered under asset transactions. Tax benefits and risks stay with the original asset owner. Employees and all rights and obligations connected with the labor contracts transfer alongside the respective assets by virtue of law. However, a number of other assets (business contracts, loan agreements, other types of contractual arrangements, etc.) may be transferred only with the consent/approval of the relevant third party. If assets are acquired, the buyer's tax basis in the assets may be increased to reflect the actual purchase price. Certain liabilities may pass to the buyer in any case, for example, environmental liabilities linked to the real estate transfers to the new owner of the real estate if the real polluter is not identified.

Czech law permits the transfer of a going concern or part of a going concern as part of an asset sale, under which, by virtue of law, all assets, liabilities and other items of the balance sheet of an enterprise (or its selected separate part) transfer to the buyer alongside the rights and liabilities attached to the enterprise (including agreements and contracts with third parties). However, some elements of the rights and liabilities connected with the corporate entity itself (corporate issues, tax liabilities, rights and obligations of stakeholders of the entity or its boards, public licenses) stay with the original corporate entity.

Favorable tax attributes of the target company will normally be lost in an asset acquisition. An asset acquisition is also more complex than a share acquisition because all assets must be properly identified and explicitly listed. For the transfer of liabilities or agreements or other types of contractual relationships, the buyer needs to seek approval from the party to the contract or liability. An asset acquisition will generally trigger "anti-assignment" clauses in the target's key contracts, licenses and permits, necessitating third-party consents for the transfer of certain valuable assets of the target. These consents may not be obtainable or may be obtainable only at a significant price or after long delays.

Approvals/registrations

Foreign investment

There is currently almost no regulation or restrictions of foreign acquisitions of Czech-based businesses, so there is little in terms of exchange controls, government regulation, or licensing of foreign investment or foreign acquisitions in the Czech Republic. There are some requirements and restrictions for investments in the defense industry. The Czech government has the right to review acquisitions in a highly strategic Czech company if the acquisition may have a significant effect on the Czech Republic.

A new bill on foreign investment screening was approved by the Czech Government and will be discussed by the Czech Parliament later in 2020. According to the bill, any acquisition by non-EU investors of at least a 10% stake or other form of effective control in a Czech company doing business in the defense sector or operating an element of critical infrastructure will be subject to approval by the Ministry of Industry and Trade. The Ministry will issue the approval where it concludes that the investment will not compromise the security of the Czech Republic or its internal public order. In the case of foreign investments in the media sector, a mandatory consultation procedure with the Ministry is proposed. The Ministry would also be authorized to review any other foreign investment capable of compromising the security of the Czech Republic or its internal public order within five years of its completion.

Merger control

Czech antitrust law derives from European competition legislation and follows the rules and guidelines of the European Commission and European courts. Czech antitrust law prohibits any acquisition or merger that would have the tendency to lessen competition or create a monopoly. Although a number of factors are considered when assessing the effect of a transaction on competition, market concentration is commonly the most important factor. Generally, a combined market share of 40% or less is not likely to lead to a refusal to approve merger clearance by the Czech antitrust authority.

The mergers are subject to Czech antitrust authority approval if:

(i) the total aggregate domestic turnover of all the concerned undertakings achieved, in the last accounting period in the Czech market, a figure exceeding CZK 1.5 billion and each of at least two of the concerned undertakings achieved, in the last accounting period in the Czech market, an individual domestic turnover exceeding CZK 250 million;

or

(ii) the individual domestic turnover in the last accounting period in the Czech market achieved by (a) at least one undertaking concerned in the case of a merger; or (b) the target in the case of acquisition of control over the target, exceeds CZK 1.5 billion and, at the same time, the worldwide net turnover achieved in the last accounting period by another concerned undertaking exceeds CZK 1.5 billion.

Employment

A share transaction does not trigger any obligations of the buyer or the target company towards existing employees or trade unions, other than a courtesy notification to the employees and trade union of the ownership change. An ownership change does not trigger any rights of the employees or trade unions.

Under asset transactions, the European Regulation on Protection of employment under transfer of undertakings ("**TUPE**") is applicable in the Czech Republic. Employees generally follow the business activity transfer and are transferred by virtue of law to the buyer alongside the assets. Generally, all rights and liabilities attached to the employment follow with the employees.

Tax

There is no stamp duty on the transfer of shares or other ownership participations. Czech tax residents are subject to Czech income tax on their worldwide income. Czech tax non-residents are subject to Czech income tax only on their Czech-sourced income, which includes the sale of assets or shares. Czech-sourced income subject to Czech income tax could be modified by a relevant double tax treaty.

Capital gains from the sale of fixed and financial assets are taxable at the general corporate income tax rate of 19% (5% for mutual, investment and pension funds). Capital gains realized by Czech tax non-residents from the sale of shares/ownership interest in a Czech company to a Czech tax resident (or to a Czech permanent establishment of a Czech tax non-resident) represent Czech-sourced income subject to Czech income tax. Nonetheless, this tax on capital is normally eliminated by the applicable double tax treaties (with numerous exceptions).

Capital losses from the disposal of tangible and intangible assets are generally recognized as tax deductible (with exceptions for loss from sale of land). Losses on securities, shares not valued at market value (shares in subsidiaries), promissory notes and other items (e.g., receivables, ownership interests in limited liability companies), are non-deductible and cannot be carried forward.

Tax grouping has not been introduced; therefore, each taxpayer must file its own tax return and any intra-group transaction cannot be consolidated for Czech income tax purposes. Furthermore, the fiscal unity concept has not been introduced and it is not possible to offset intra-group losses and profits (with certain exceptions for partnerships).

The EU Parent Subsidiary Directive is part of Czech tax law and allows distributed dividends to be exempt from tax under explicit conditions. Mergers (as well as de-mergers, capital contributions and share exchanges) are generally treated as a tax-neutral operation with no tax on non-realized incomes arising from the mergers.

The ordinary asset transaction will bear VAT at the standard rate of 21%.

Careful review and planning are required if the target company has any governmental subsidies, as these subsidies will frequently be lost in asset transfers, or the Czech authorities might require that they be returned.

Post-acquisition integration

The process of post-closing integration is very much driven by the needs of the buyer, but if well planned even before the transaction, then it usually just requires administrative efforts. Items like IT integration, branding matters, post-closing tax planning and other post-acquisition integration concerns that drive value are achievable in the Czech environment, and they do not frequently trigger obstacles from the side of the Czech authorities.

Careful planning is required as, for example, any employment lays-offs, obtaining new business licenses or post-transaction tax optimization may require time or extra financial resources.

Common deal structures

What are the key private M&A deal structures?

In general, there are five key methods of structuring an acquisition:

- acquisition of shares (participation interests);
- acquisition of assets;
- acquisition of an enterprise;
- merger (i.e., amalgamation or consolidation) and de-merger (de-merger or spin-off); and
- transfer of assets to a participant or shareholder/squeeze-out

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

The most commonly used types of company are limited liability companies and joint stock companies.

What are the different types of limited liability companies?

A limited liability company may be established by one or more individual(s) or by one or more corporate entity/entities (there is no maximum limit on the number of participants). Liability of the participants is limited (up to the total unpaid value of the participation interests as registered in the commercial register).

Shares in a Czech limited liability company are represented by participation interest. If the constitutional document provides for it, the company can issue a participation certificate representing and incorporating the participation interest. The incorporation of the participation interest into the participation certificate will enable the participation interest to be easily transferred.

The minimum capital contribution of each participant is CZK 1. The company founders may decide on a higher registered capital. Before filing a petition for registration of the limited liability company into the commercial register, the whole contribution premium and 30% of each participant's capital contribution must be paid (the remainder of the initial capital must be paid within five years of the company's registration). Subject to certain conditions, in-kind contributions may be made to the company's registered capital.

A limited liability company has no board of directors; instead, the company is represented by one or more executives. The executives can, however, form a board if the constitutional document of the limited liability company provides for this. A limited liability company may establish a supervisory board as a controlling body, but the establishment of a supervisory board is not mandatory.

A joint stock company may be established by one or more individual(s), or by one or more corporate entity(ies). The shareholders of a joint stock company are not liable for the company's obligations.

The capital stock of a joint stock company is divided into shares, which may be issued in the form of bearer or registered shares. Registered shares can be issued as certified shares or can be maintained in the form of book-entry (computer entry) securities in a special account at the Central Securities Depository, which is maintained by *Centrální depozitář cenných papírů*, or which can be deposited with a bank or another financial institution. To increase the transparency of the ownership structure of the joint stock companies, bearer shares can be issued only as book-entry securities, or as securities deposited with a bank or another financial institution. Certified bearer shares that have not been deposited with a bank or another financial institution prior to 1 January 2014 are transformed automatically to certified registered shares (with effect since 1 January 2014) under the Act on Certain Measures to Increase the Transparency of Joint Stock Companies. A joint stock company can issue either shares with a nominal value or shares without a nominal value. Those shares that do not have a nominal value each represent an identical share in the registered capital of the company. Where shares without a nominal value are issued, the company may not issue any other shares with a nominal value.

The minimum registered capital of a joint stock company is CZK 2 million. If a joint stock company keeps books in euros the minimum registered capital of a joint stock company is EUR 80,000.

The joint stock company can have either a monistic or a dualistic structure of corporate management. A dualistic structure anticipates that the company's bodies will include (in addition to the General Meeting) the board of directors and supervisory board. The monistic structure means that, in addition to the General Meeting, the company's bodies will include one statutory director and a board of trustees. As of 1 January 2021, joint stock companies with monistic structure will only need to have a board of trustees as the only corporate body.

A joint stock company must maintain webpages in which it will publish certain statutory information (e.g., information that must be stated on the business documents, etc.).

Is there a restriction on shareholder numbers?

A limited liability company does not have any restrictions on numbers of shareholders; neither does a joint stock company.

What are the key features of a share sale and purchase?

From a transactional point of view, a share transaction is much simpler and usually involves less documentation than an asset transaction. Generally, public licenses and permits are not affected.

What are the key features of an asset sale and purchase?

In an asset sale, the parties are generally free to select the assets and liabilities they wish to transfer. The buyer will generally be liable only for those obligations of the acquired company which it expressly assumes. However, an asset acquisition is generally more complicated and involves more documentation than a share acquisition. As a general rule, public licenses and permits cannot be transferred but must be reapplied for by the buyer.

Czech law governs the sale of an 'enterprise' separately. The same rules also apply to sales of a part of an enterprise as long as that part represents a 'golden egg' (i.e., it is a material part of the enterprise, the sale of which would represent a material change of business/activities of the seller). The parties are free to exclude an individual asset or a liability as long the entire unit still represents an 'enterprise'.

In a sale of an 'enterprise', the selling entity transfers title to the enterprise (as a whole) to a buyer. Transactional documentation is generally more complicated and involves more documentation than in share acquisitions. The assets, contracts and liabilities of the seller pertaining to the enterprise pass to the buyer without the consent of creditors. The buyer, however, takes over only those liabilities which were known to it, or which the buyer must have reasonably expected. As a general rule, public licenses and permits cannot be transferred, but must be reapplied for by the buyer.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

The key purpose of the New Civil Code is to provide a certain level of protection to a contracting party where the other party withdraws from negotiations without justified grounds. In general, each negotiating party shall only be liable for failing to enter into a contract if such party started (or commenced) the contractual negotiations without an honest intention to enter into such contract. This is also emphasized by another general rule of the New Civil Code that stipulates that each shall transact with others with honesty. It is considered that this general rule means that each shall act in good faith when transacting with others.

The New Civil Code also provides that the contracting parties should notify each other of any significant actual and legal circumstances that could be important to the contract to be concluded. If the contractual negotiations reach a certain stage (i.e., the contract is nearly finalized), no contracting party can withdraw from the execution of the agreement without justified grounds.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: It is fairly common to include provisions on exclusivity in letters of intent or term sheets.
- Break fee: It is rare to include provisions on break fees in letters of intent or term sheets.
- Confidentiality: It is very common to include provisions on confidentiality in letters of intent or term sheets.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

It is not very common to prepare separately negotiated agreements as the relevant details are usually sufficiently contained in the term sheet. However, if a public limited company is a party to the term sheet, it is fairly common that the confidentiality provisions are supplemented in a separately negotiated agreement due to the complexity of the issue.

Is there a duty or obligation to negotiate in good faith?

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Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: fairly common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: a combination of net working capital and net debt is fairly common.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely; collars are not common.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: usually target or buyer.

Is the balance sheet audited (where applicable)?

Frequency/market practice: very common.

Is an earn-out common?

Frequency/market practice: fairly common; earn-outs are limited to transactions where sellers are continuing in the management of the target after closing.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: fairly common.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: rarely.

Is the MAE general or specific?

Frequency/market practice: both are seen.

Is the MAE quantified?

Frequency/market practice: rarely.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common but difficult to get from private equity sellers or in some sector segments.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: rarely; waterfall/blue pencil provisions are not common.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common (in conjunction with non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common (in conjunction with non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; depends on the sophistication of the parties. This is common for private deals but there is frequently resistance from sellers. There are competition law issues around potential 'gun-jumping.'

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: fairly common; updating schedules is common but limited to things like lists of contracts. Notification of possible breach is common. Where there is a material breach, there is a right to terminate.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen but often not quantified (other than specific warranties, e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are growing. They are often limited to actual knowledge and due enquiry of a specified list of senior management.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common; still commonly requested by buyers, but often resisted by sellers.

Is disclosure of the data room common?

Frequency/market practice: fairly common.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common; repetition at completion is common. Bring-down certificates are not very common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: fairly common; repetition at completion is common. Bring-down certificates are not very common.

Is a bring-down certificate at closing common?

Frequency/market practice: rarely; bring-down certificates are not very common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: fairly common; true and accurate in all material respects is the common standard, but there is often a carve-out for fundamental representations, which must be absolutely true and accurate.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: it is commonly less than 100%. Mid-cap and larger deals see lower caps, e.g., 20%-50%.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: usually warranties only.

What are the common exceptions to the cap?

Frequency/market practice: key warranties (e.g., title) are typically excepted. Often, tax and environmental indemnities and other specific indemnities are also excepted. Separate caps are common.

Is a deductibleor basket common?

Frequency/market practice: both deductible or basket is fairly common (to exclude small claims).

Is a de minimis common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: a general survival of 12–24 months is common. It is also common to carve out fraud. Tax is commonly longer than general warranties — it usually matches statutory limitation of three years.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: fairly common; tax is commonly longer than general warranties — it usually matches statutory limitation of three years.

Is warranty insurancecommon?

Frequency/market practice: rarely.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common for actually received.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common for actually received.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: fairly common.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: rarely; in fact, often silent.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: Czech law.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is more common; Prague Arbitration Court (Arbitration Court allocated to Czech Economic and Czech Agricultural Chambers), VIAC, or ICC.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: no stamp duty is payable.

Is a separate tax covenant / indemnity or tax deed common?

Frequency/market practice: fairly common.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Egypt

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

Finalizing due diligence before execution of the acquisition agreement is market practice in Egypt. A due diligence exercise would usually cover corporate structure, licenses and permits, property titles, regulatory, tax, labor and social security compliance, material contracts, change of control provisions, litigations and environmental matters.

Typically, issues highlighted during the diligence process are dealt with as matters to be rectified by the seller as a condition precedent to closing, by a purchase price reduction or by indemnities given by the seller.

Payment

The Financial Regulatory Authority ("**FRA**") requires that the purchase price of shares, for both listed and unlisted shares, be deposited in an Egyptian bank if the transaction (i) exceeds EGP 100,000, or (ii) the seller and/or the buyer is a non-Egyptian entity or a foreigner.

Payment must be effected through the Egyptian Exchange ("**EGX**"), using a broker licensed by the FRA. The EGX accepts the following two mechanisms for settlement of the purchase price:

1. The purchase price is deposited in the broker's Egyptian bank account. The broker then transfers the purchase price to the seller's bank account once the share transfer has taken place through the EGX; or

2. The purchase price is deposited in the seller's Egyptian bank account directly. The FRA regulations allow for this mechanism if the purchase price is deposited within one month, at most, before submitting a request for the share transfer.

An escrow bank mechanism will also be acceptable, provided that the purchase price is deposited in an Egyptian bank account. There are some exemptions to the cash deposit requirement, for example, this requirement does not apply to a transfer of shares between ancestors and descendants, or between a company and its subsidiaries for restructuring purposes, and share swaps. In any event, such exemptions from paying the purchase price must be approved by the FRA.

Signing/closing

Share sale

Any transfer of unlisted shares in an Egyptian joint stock company (the most commonly used business vehicle in Egypt) must take place before the EGX through a licensed broker, and the transfer of title to the shares is evidenced by the EGX transfer certificates when such shares are not deposited/registered with Misr for Central Clearing, Depository and Registry ("**MCDR**"). However, if the shares being transferred are registered with the MCDR, the legal document evidencing completion of transfer of title is the custodian statement. Now, it is required by law that all shares of joint stock companies be registered with the MCDR. Usually, the seller and the buyer contract the same broker to execute the transaction before the EGX. It is possible for each party to appoint its own broker, but this will require extra cost.

The process of transferring title to unlisted shares of a joint stock company involves several procedures, including:

- a codification process (i.e. creating a unified EGX code for the trading parties);
- a share trading process, which includes preparing and submitting a set of documents by the seller, the buyer as well as the issuing company. The EGX usually takes three business days to review the transaction file and request any further documents. The pricing committee within the EGX would need to review the transaction's file and approve it in specific cases, including if a transaction's or a group of related transactions' purchase price is equal to or exceeds EGP 20 million; and
- The EGX usually issues the share transfer certificates proving the transfer of the sold shares to the buyer on the same day of execution. However, if the shares being transferred are registered with the MCDR, the transaction goes through the MCDR following its execution at EGX.

Asset sale

There is no legal framework regulating asset sale deals in Egypt. The process is done though separate transactions to cover the transferred business components, such as the sale of real property, assignment or contract amendment, licenses and permits amendments or transfers, etc.

Asset sale deals exist ideally where there is a restructuring or splitting of business units. Completion of asset transfer is time consuming, particularly with regard to the transfer of employees and the sale of real property due to the registration process at the notary public.

Approvals/registrations

Foreign investment

Generally, there are no foreign investment restrictions in Egypt. In 2017, substantial reforms were introduced to create the new Investment Law, aimed at attracting new investments to Egypt by providing additional incentives and guarantees, removing the existing impediments for foreign and domestic investment, protecting investors from bureaucracy and corruption, and streamlining the procedure for establishing projects and obtaining licenses. However, some industries or sectors may require minimum percentages of Egyptian shareholding or participation, such as carrying out commercial agency activities, importation for re-sale purposes and security activities. As a general rule, a foreign investor must apply for a security clearance as part of the procedure for investing in Egypt or setting up a company. This clearance includes the submission of a specific form covering the required personal and business-related information. Submission of the form in itself does not hinder the investment in Egypt, except for certain nationalities where the security authorities do not allow for investment before clearance has been obtained. In addition, investment, conducting business, ownership of real estate properties in Sinai by foreigners has some security-related restrictions whereby the prior approval of the Sinai Development Authority is required.

Otherwise, there are generally no issues with foreign investment in Egypt. The new Investment Law grants foreign investors the same treatment as Egyptian investors in a manner incentivizing investment. Examples of incentives granted by the Investment Law include (i) granting investors the right to set up and operate their businesses in foreign currencies transferred from abroad without restrictions, (ii) permitting foreign investors to freely dispose of their assets, liquidate their projects and convert proceeds in local currency into foreign currency through registered banks without restrictions and (iii) investment projects also have the right to export their products without a license or being registered in the Register of Exporters.

Merger control

According to Article 19 of the Law number 3 of 2005 on the Protection of Competition and the Prohibition of Monopolistic Practices ("**ECL**"), and Article 44 of the Executive Regulations issued by virtue of the Prime Ministerial Decree number 1316 of 2015, persons who have an annual turnover in the latest financial statement that exceeds EGP 100 million (combined) must notify the Egyptian Competition Authority upon acquiring any assets or shares or ownership rights of another person or entity (directly or indirectly) within 30 days of the transaction becoming effective.

This notification system does not grant the Egyptian Competition Authority ("**ECA**") any right to appraise the transaction. In other words, the ECA does not have the right to block, allow or impose remedies on the transaction. There are a number of points that would need to be clarified;

- From a practical perspective, while the requirement to notify the ECA is on both the buyer and the seller, in all previous cases brought by the ECA against persons failing to notify the ECA within 30 days, the ECA brought the action against the buyer only and not the seller.
- The notification needs to be submitted within 30 days from the date of the transfer of shares. The ECA interprets "the transaction becoming effective" as the date of the transfer of shares from the seller to the buyer.

Egypt is a member state to the Treaty establishing the Common Market for Eastern and Southern Africa whereby it requires pre-approval when the parties to a transaction have operations in two or more member States and when the transaction meets certain thresholds.

Other regulatory or government approvals

Generally, there are no other specific approvals required. However, depending on the sector of business, certain approvals may be required from certain governmental bodies. For example, certain approvals of the Ministry of Health may be required for transactions in the health sector, and certain approvals may be required from the Central Bank of Egypt, or the FRA for transactions in the banking sector.

Employment

Egyptian labor law is largely employee-biased, designed to protect employees. The most common employment issues relevant to M&A transactions in Egypt are layoffs or employee transfers following the acquisition.

For employees who are laid off, the acquiring entity, as a market practice, compensates them with severance packages equivalent to that of unjustified termination of employees, which may amount to two months per year of service (for unlimited-term employment contracts), and a salary equivalent to the remaining period for limited-term contracts in addition to the termination notice period.

Further, the Egyptian Labor Law regulates redundancy of employees for economic reasons. This can be relevant to entities prior to or post M&A transactions. However, in practice, redundancy is a timely process.

Tax in Egypt strongly depends on practice. Recently, the following tax regulations have been introduced, which may affect M&A transactions.

Value added tax

Value added tax applies to the supply of goods and services, at a rate of 14%. All companies shall prepare and file a monthly VAT return with the relevant Egyptian tax authorities.

Capital Gain Tax

Capital gains realized by a resident/non-resident person due to the disposal of or the sale of unlisted shares will be subject to a capital gains tax at the rate of 22.5%. The capital gains is the difference between the sale price and the ownership cost of the share. The ownership cost may be determined based on different references including the book, nominal and fair market value depending on the tax analysis/assessment given by the tax advisor.

Stamp duty tax

A new "Stamp Tax/Duty" regime applies to the total value of trading in securities (i.e., Egyptian or foreign securities, listed or unlisted), excluding public treasury bills and bonds, without any deductions regarding expenses.

Stamp duty taxes on unlisted shares (private acquisition) is 0.15%; and is raised to 0.3% when the transaction is a sale or acquisition of 33% or more of the shares or voting rights of a company.

If multiple transactions conducted by one legal person related to a company exceed this 33% limit during the two years following the first transaction, the seller and buyer are subject to a 0.3% rate on the total amount of the transactions, with the right to offset any stamp duty already paid on the transactions.

Post-acquisition integration

There are no post-acquisition integration rules in Egypt. Post-acquisition integration would usually take the form of employees restructuring process, and transitional technical and management services/assistance to be provided by the seller to the acquired target for an interim period of time.

Common deal structures

What are the key private M&A deal structures?

Egyptian law permits different means of obtaining control of a business in Egypt: through acquisition of shares, acquisition of assets, swap of shares, or mergers. Acquisitions of shares and mergers are most common.

The Companies Law and Capital Markets Law regulate shares swaps between companies. The shareholders of the target company will assign its shares to the buyer in return for shares in one or more other company via a swap of shares. The Companies Law regulates mergers of companies. One or more companies may merge into an existing company or may merge with each other to form a new company. The merger may take place even if the merged company is in liquidation, provided that the prior approval of the competent authorities is obtained to cancel the liquidation.

The merger must be approved by an extraordinary general assembly resolution of each of the companies. This approval will be subject to the voting requirements prescribed by the articles of each of the companies. The Companies Law prescribes a voting threshold of 75% for merger decisions. That said, unanimous shareholder approval is required in the event of a merger, which results in an increase of the shareholders' liability.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

The most common type of target entity in Egypt is a joint stock company.

The main reason for this is that joint stock companies have a more organized management structure and more stringent corporate governance requirements. In addition, in cases where high funds are to be allocated, the choice of establishing a joint stock company becomes appealing as there are no requirements to pay the full capital upon establishment. The capital can be paid in full over five years.

What are the different types of limited liability companies?

There are no different types of limited liability companies. In Egypt, limited liability company ("**LLC**") capital must be divided into quotas of equal value. The quotaholders are entitled to determine the par value of quotas. Quotas must be of equal rights. Limited liability companies may carry out any activity except for certain activities, such as insurance, banking, savings, deposit taking, investment funds, securities brokerage or portfolio management activities.

Is there a restriction on shareholder numbers?

A joint stock company is made up of at least three shareholders. There is no maximum limit on the number of shareholders.

Limited liability companies must have a minimum of two quotaholders at all times and can have up to a maximum of 50 quotaholders.

Shareholders or quotaholders may be natural persons or juristic persons (legal entities).

Recently, the authority has also introduced a single person company, which is akin to a limited liability company but could be formed with a single shareholder only.

What are the key features of a share sale and purchase?

Transfer of title to shares in joint stock companies must be executed by a brokerage company licensed by the FRA, even for unlisted shares. The mechanics of processing the transaction vary depending on whether the shares are listed or not, but in both cases it is effected through the Egyptian Stock Exchange. The time required to execute such transactions is approximately one to three business days. However, deals above a threshold of EGP 20 million require the approval of the Trading Committee and, hence, usually take approximately five business days.

The following procedures have to be satisfied for transfer of title to the shares:

a. signing the transaction documents including the share purchase agreement;

b. appointing a broker for the purpose of executing the share sale and purchase transaction;

c. duly signing the sale and purchase orders along with provision of documents so required by the EGX;

d. the sale consideration will have to be physically deposited or transferred as below; and

e. once all the documents necessary to execute the transaction are in place and the sale consideration is deposited or transferred, the broker shall proceeds with transferring the title to the shares at EGX.

Payment of the sale consideration/Exceptions:

The sale consideration has to be physically made against any share transfer. Pursuant to FRA Decree No. 17 for 2017, any brokerage firm executing a transaction has to deal with its clients through a bank account opened at any of the banks approved by the Central Bank of Egypt for any transaction that exceeds EGP 100,000. The brokerage firm executing the transaction at EGX will have to submit to EGX on the date of transfer of title a statement confirming that the purchase price is deposited in/transferred to the seller bank account (or escrow bank account if applicable). Article 7 of the decree provides that the brokerage firm shall ensure that the buyer has deposited/transferred the consideration of the sale shares to the brokerage bank account upon executing the transaction, or to the seller's bank account within, at most, one month before the date of submission of the sell/buy orders to EGX. No payment of sale consideration is required:

(i) in the event the transfer of title to the shares is made between a buyer and its affiliates;

(ii) as a result of a share swap provided that the swap is made between Egyptian Companies; or

(iii) in the case where FRA so approves in other cases.

Transfer of title to quotas in limited liability companies must be executed/completed by having (i) the register of quotas; and (ii) article 5 of the articles; both changed to reflect the transfer of title. The articles of association of the target company will define whether or not the quotas sale agreement must be notarized or not. A quotaholders resolution must be issued to amend the shareholding structure of the company.

What are the key features of an asset sale and purchase?

Civil law applies to acquisitions of assets, regulating the relationship between sellers and purchasers. Usually, an asset transaction takes the form of an asset/business transfer agreement. Transfer of assets takes much more time for completion/closing to take place; it is a time-consuming process as assets and business components have to be transferred through separate transfer instruments /procedures. Depending on the type of asset to be transferred, a third party consent will be required for enforceability.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

Heads of terms, letters of intent, expressions of interest or term sheets are customary in Egypt. Such documents are usually non-binding except for the clauses relating to exclusivity, confidentiality, governing law and dispute resolution. Egyptian law places great emphasis on the intent of the parties, so any such documents must make clear that they are not intended to create binding obligations. These documents must have a longstop date to enable the parties to pursue a different transaction after a certain period of time.

Is there a duty or obligation to negotiate in good faith?

No, there is no obligation to negotiate in good faith.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: purchase price adjustments are common. However, we have seen a rise in locked-box pricing as well over recent year.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: market practice sees different types including working capital adjustment, cash-free, debt-free and EBITDA.

Is there a collar on the purchase price adjustment?

Frequency/market practice: collars are not common.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: very common; both parties, or the buyer (in the case of full acquisition) or the seller (if the seller would retain majority shares), depending on the contractual arrangement, would procure the target company to instruct a third-party auditor (as selected by the parties) to prepare the completion balance sheet.

Is the balance sheet audited (where applicable)?

Frequency/market practice: very common.

Is an earn-out common?

Frequency/market practice: earn-outs are fairly common in private equity transactions when the sellers continue to manage the target company after closing. They are not common where the seller is completely exiting, though market practice has seen a few cases of earn-out in such scenarios more recently.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: very common.

Is a break fee common?

Frequency/market practice: rarely unless the acquisition is run through an auction process.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: very common.

Is the MAE general or specific?

Frequency/market practice: it varies from deal to deal.

Is the MAE quantified?

Frequency/market practice: fairly common.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: blue pencil provisions are common. Waterfall provisions are rarely used.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: very common (in conjunction with non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: very common (in conjunction with non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: access is common, but 'broad access' varies from deal to deal.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: updating warranty disclosure is rare. Notifying a possible breach is a common provision for termination in the transaction documents. In cases of material breach, there is a right to terminate.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: materiality qualifiers are very common, and the materiality qualifiers are usually quantified by certain amounts or by MAE.

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: it varies from to deal to deal. Usually, the warranties are qualified by either limiting the knowledge to a list of key persons, or by implied/actual/constructive knowledge, or by knowledge known within specific organs/bodies within the target company, such as the board meetings or a combination of all of these qualifiers.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: this is still commonly requested by buyers, but is often resisted by sellers.

Is disclosure of the data room common?

Frequency/market practice: fairly common.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: repetition at completion and at all times between signing and completion is fairly common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: repetition at completion and at all times between signing and completion is common.

Is a bring-down certificate at closing common?

Frequency/market practice: bring-down certificates at completion are uncommon.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true, correct and accurate in all material respects is very common with respect to the fundamental warranties (e.g., title and ownership). As to the operational warranties (e.g., assets and conduct of the business), we see the sellers pushing back significantly on this by requesting materiality qualifiers to be added to the operational warranties. The qualifiers may take the form of "material respects" or "**MAE**".

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely; only in the warranties that are very broad by nature.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: the amount ranges from 10%-40% of the purchase price. Key warranties, such as tax liability and fundamental warranties, are generally unlimited or limited to 100% of the purchase price.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: they usually apply to warranties only.

What are the common exceptions to the cap?

Frequency/market practice: key warranties are generally excepted (e.g., title, capacity, authority). Fraud and gross negligence are also excepted. Often specific areas of concern, such as tax, employment and environmental, have specific higher caps.

Is a deductible or basket common?

Frequency/market practice: a basket is common.

Is a de minimis common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: the general survival is 18-24 months or a year following the approval of the first financial statements of the target company post-completion.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: it is common to carve out key warranties (e.g., title, capacity, authority, tax, employment and environmental) as well as fraud and gross negligence or significantly expanding the key warranties survival period (e.g., 7-10 years).

Is warranty insurance common?

Frequency/market practice: rarely.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: very common; (net of any cost, including legal fees, for recovery of insurance proceeds).

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: very common; (net of any cost, including legal fees, for third-party recoveries).

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: very common; required by law.

Is there an exclusion of consequential damages?

Frequency/market practice: very common; required by law.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: rarely; it varies from deal to deal based on the negotiating leverage of each party. It is common to state in the share purchase agreements that only information disclosed in the disclosure letter disarms the buyer from the opportunity to raise claims against the seller.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes, if it is not contrary to public policy.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is very common. National or international arbitration (usually ICC or LCIA), depending on the nationality of the parties.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: yes, stamp duty tax is to be paid by each party.

Is a separate tax covenant / indemnity or tax deed common?

Frequency/market practice: fairly common; it is very common to have the tax warranties and tax indemnities in the same contract.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

Guide to Navigating Global Private M&A

France

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

In France, pre-acquisition due diligence is standard. While the issues that a foreign investor should be aware of will be determined by the particularities of the transaction and target company or business, some key issues in a due diligence of a French target include the following:

– Employment: French employment law is complex with a comprehensive Labor Code (*Code du Travail*), with little scope for individual negotiation.

– Compliance: Compliance matters have become key issues since the entry into force of (i) the Sapin II Law relating to transparency and anti-corruption, which requires large companies (with at least 500 employees and an annual turnover in excess of EUR 100 million) to implement compliance programs, and (ii) the Duty of Vigilance Law which requires French companies with more than 5,000 employees in France or more than 10,000 employees in France and abroad, to undertake reasonable measures to prevent human rights violations, severe physical or environmental damage, and health risks resulting from the activities of the company, the companies it controls directly or indirectly, as well as the subcontractors and suppliers with which the company has established business relationships.

– Data Protection: Data protection issues are becoming more important in light of the EU General Data Protection Regulation, which extends personal data protection and increases sanctions for non-compliance.

Pricing and payment

Independent appraisals are not required to support the valuation of the target in a share or asset deal. Buyers typically rely on their internal valuations.

Purchase price adjustments are common. The choice of adjustment generally depends on the calculation method of the purchase price and type of business operated by the target. It is common for the purchase price to be stated on a "cash-free debt-free" basis, with a purchase price adjustment based on target working capital for the purpose of confirming the value of the target company at closing. Although less common, the purchase price may be stated to be "cash-free debt-free" on the basis of a locked box mechanism based on locked box accounts prepared as close as possible to the signing date. A locked box mechanism is typically used in private equity transactions where the selling party is a private equity fund. Earn-outs are sometimes seen in smaller transactions where the management by the sellers is key to the target business for a transition period after closing, or in deals involving start-up or bio-tech businesses, the valuation of which is uncertain at the time of the transaction.

From a legal perspective, there are generally no restrictions regarding the payment of the purchase price in or out of France, as there are few controls over foreign exchange transactions. Most commonly, the purchase price is paid in Euro. However, payment in other currencies or a consideration by way of shares is also possible. (The Euro equivalent of the purchase price amount, if not paid in Euro, needs nevertheless to be determined (or determinable) for tax registration purposes). If the purchase price does not reflect the fair market value, this may have tax consequences. French transactions also commonly provide for an escrow arrangement (and more rarely for the holdback) for part of the purchase price to secure the payment of any future purchase price adjustment or indemnities given for breach of the sellers' representations and warranties or specific indemnities.

Signing/closing

The Civil Code provides for an express obligation on parties negotiating a transaction, including a sale of shares, assets or business, to negotiate in good faith. This duty applies both in pre-contractual negotiations and during performance of the contract. The duty includes the obligation to inform the buyer of relevant important facts that the buyer could not discover on its own. Also, where negotiations are at an advanced stage giving rise to a reasonable expectation that the transaction will proceed, the unilateral termination of the negotiations by a party may give rise to damages if such termination is characterized as unfair/wrongful.

Whether signing and closing is simultaneous or non-simultaneous will depend on the conditions and complexity of each transaction, and in particular if any third-party prior approval (e.g., antitrust or foreign investment approval) is required. Both mechanisms are common.

Approvals/registrations

Foreign investments

Generally, the French legal system encourages foreign investment, with no restrictions on foreign ownership of companies, with the exception of M&A transactions (whether by way of share or asset sale or merger) in a "sensitive sectors" (sectors of key importance for the French state), which require the prior authorization of the Ministry of Economy ("**MoE**"). Sensitive sectors include notably the following areas or activities to the extent they are likely to prejudice the interests of national defense, public order or public security:

- private security, weapon and ammunitions, terrorism, toxic substances, antidotes, cryptology, dual-use items or technology, classified information, direct or indirect supply agreements with the Defense Ministry;
- activities relating to notably essential infrastructure, goods or services, to guarantee integrity, security and continuity of supply of energy, water supply, transportation networks and services, electronic communication networks and services, data hosting activities, press, installations of vital importance and public health;
- research and development activities relating to critical technologies: cybersecurity, artificial intelligence, robotics, additive manufacturing, semiconductors, quantum technology, energy storage and biotechnologies;

When an investment requires prior authorization, the foreign investor must file a request to the MoE and obtain clearance before closing the transaction.

The prior authorization process involves two phases:

Phase 1: The MoE must respond within 30 business days from receipt of a complete request for prior authorization and indicate if (i) the investment is out of the scope of the foreign investment regulations, (ii) is in-scope and authorized or (iii) in-scope and requires a more in-depth analysis.

Phase 2: If during Phase 1, the MoE determines that a further analysis is required to ensure that the contemplated transaction is made under conditions preserving French national interests, it may request a second phase of review up to 45 business days from the date on which it notified its decision in Phase 1.

During this period, the MoE may request specific commitments from the investor. Discussions of commitments suspend the 45 days period.

If the MoE does not provide its position on the expiry of either phase, the prior authorization request will be deemed denied.

The MoE may involve other relevant ministries during the review process, depending on the sector.

Before filing a proper request for authorization, the foreign investor or the target company may formulate a request to the MoE aiming to confirm whether the target's activity is deemed sensitive or not. The MoE shall provide its answer within two months from receipt of all necessary information. Note that lack of response within this timeline does constitute an implied confirmation that the activity is not sensitive.

Merger control

An acquisition of a French target or target company with sales in France may be subject to EU or France merger control. If an acquisition is subject to EU merger control, it will fall outside the remit of France merger control (however a EU dimension is not met if each of the companies achieve more than two thirds of its EU-wide turnover in France).

The French Competition Authority ("**FCA**") has jurisdiction in international mergers where the following thresholds are met, irrespective of the nationalities of the parties and/or "center of gravity" of the transaction (i.e., the authority will not look at the location of the business headquarters or its corporate documents):

- The parties to the merger have a combined annual worldwide turnover, exclusive of taxes, in excess of EUR 150 million;
- The French annual turnover, exclusive of taxes, achieved individually by each of at least two parties to the merger exceeds EUR 50 million; and
- The European merger control thresholds are not met.

In addition, there are specific lower thresholds for concentrations in the retail sector or in overseas territories.

If the turnover thresholds are met, a notification will be required. The FCA may block a merger or impose conditions if it finds that the proposed merger is likely to significantly restrict competition, particularly by creating or strengthening a dominant position in the French market. It thus ensures in advance that merger will not restrict competition and, if there is a risk to competition, only clears them on the condition that appropriate solutions are implemented.

Any company that meets the conditions to notify a transaction but fails to refer it to the FCA risks a heavy fine for failing to notify.

Employment

Obligation to consult the CSE

Generally, where a business is acquired by a share or asset sale, the management of the target company must inform and/or consult the target's employees and if applicable, the social and economic committee (*comité social et économique*) ("**CSE**"), about the proposed sale.

Companies with more than 11 employees must have a CSE. For companies employing between 11 and 49 employees, the CSE has limited power and is not consulted on share or asset sale. For companies employing more than 50 employees, the powers of the CSE are extended and the CSE must be consulted on a share or asset sale.

The Labor Code requires the target's management to inform the CSE about the proposed sale and consult it to obtain its opinion. This involves the target's management giving the CSE an information note on the proposed sale and consequences for employees. The consultation process must take place between one and three months before any binding agreement or letter of intent is signed, even at the parent company level, if that agreement involves France and French management is aware of it. This consultation requirement can affect the parties' ability to keep the acquisition confidential.

Although the CSE cannot prevent the proposed sale (unless the purpose of the transaction is to deny employees of their rights), the CSE can apply for a court order to have the transaction suspended until the obligations to inform and consult have been complied with. A CSE may also appoint an expert to evaluate the information provided by the target, which can impact the transaction timetable. In theory the CSE bears the expert's costs, but in practice the CSE may insist that the target's management bears these costs.

Failure to consult the CSE may result in the target and the head of the target being liable for fines.

In addition, the health, safety and working conditions commission ("**CSSCT**") of the CSE should be consulted on major changes to health and safety, and working conditions in the company, which may include the sale of a business..

Hamon law obligation to inform employees

French law ("***Loi Hamon***") obliges smaller and mid-size employers to inform employees directly before a proposed sale of (i) at least 50% of the shares or (ii) the business (going concern) of their employer, with a view to allow them to make an offer to buy the shares or business. No priority or pre-emption right is granted to employees, the seller has no obligation to consider an offer made by an employee and the refusal to accept an offer need not be justified.

This obligation applies even when no consultation of the CSE is required. Companies which have no CSE consultation required (i.e., companies with less than 50 employees) must inform all employees of the proposed sale at least two months before any binding agreement related to the sale is signed. Also, the sale cannot take place before the end of this two month period unless all employees have informed the company that they waive their right to make an offer.

Companies with a CSE and between 50 and 250 employees, and which fall into the category of small or medium-sized companies (i.e., companies with a turnover below EUR 50 million or a balance sheet total below EUR 43 million) must inform employees of the proposed sale at the latest when the company's CSE is informed and consulted on the proposed sale. The sale can only take place once the works council consultation process has been completed. Failure to comply with this obligation to inform may trigger the payment of a fine of to 2% of the purchase price of the proposed sale.

Only the seller's intent to sell its shares or the business need be disclosed. The name of the proposed buyer is not required to be disclosed and the seller has no duty to provide information or documents relating to the company, its strategy or its financial statements, to employees, even if an employee has indicated its interest in buying the shares or the business. Employees are subject to an obligation of discretion under *Loi Hamon*.

Tax

Transfer taxes/VAT

A share acquisition is exempt from French VAT and subject to transfer taxes as follows:

- transfers of shares in an SA or SAS are subject to 0.1% transfer tax;
- transfers of shares in an SARL are subject to 3% transfer tax with an allowance on the taxable basis equal to EUR 23,000 multiplied by the percentage of shares transferred;
- transfers of shares in French real estate companies are subject to 5% transfer tax. A real estate company is a French or non-French non-listed company whose assets consist of more than 50% of real estate or assimilated assets in France.

The acquisition of a business (asset deal) may be subject to VAT (at 20%) and to transfer taxes under the following conditions:

- transfers of real estate assets are subject to 5.81% or 5.09% transfer tax depending on location (to be increased by notary fees and other related expenses) and may be subject to VAT under certain conditions;
- transfers of ongoing business/clientele/activity/trademarks and patents registered in France are subject to transfer tax at an escalating rate of 0% up to EUR 23,000 of taxable basis, 3% from EUR 23,001 to EUR 200,000 and 5% above EUR 200,000 and are generally exempted from VAT under specific relief;
- transfers of isolated assets may not be subject to transfer tax in certain circumstance but should generally be subject to VAT.

Transfer taxes are assessed on the purchase price or the fair market value if higher. They are normally borne by the buyer but the parties may agree otherwise. However the seller and the buyer are both severally and jointly liable for their payment to the French Treasury.

Income tax / withholding taxes

Participation-exemption regimes are available in France on dividends (95% exemption, subject to holding at least 5% in the distributing company for at least two years, or 99% for distributions within a tax group) and on capital gains on sales of substantial shareholdings/controlling interests (88% exemption, subject to a two year holding requirement).

EU laws and double taxation treaties signed by France provide for reduced rates or exemptions on withholding taxes applicable to French-sourced income.

Post-acquisition integration

After the acquisition has been completed, the target business needs to be operationally and/or structurally integrated in the buyer's structure, which can be done by way of a corporate reorganization of the business (as merger or spin-off which are eligible for specific tax deferral regimes). The form and implementation of the corporate reorganization is mainly driven by tax considerations in France and, if applicable, abroad. Also, a French company subject to French corporate income tax may form a tax group with French subsidiaries held at 95% or more.

Common deal structures

What are the key private M&A deal structures?

The purchase of a business can take a number of different forms. There are basically three techniques to take control of a business in France, i.e., through a sale of shares, a sale of assets, or through a merger/contribution of assets or shares. The legal and tax framework, however, differs significantly depending on whether the transaction is structured as a purchase of assets, a purchase of shares, a contribution of assets, a contribution of shares, or a merger.

For large businesses, auction processes are often seen in France but are less common for small businesses. The bid process is conducted in accordance with a bid process letter prepared by the advisers of the seller and usually provide for the submission by the buyer of (i) a non-binding letter of interest at an early stage of the transaction process; such letter of interest usually provides for a description of the buyer (controlling parties and strategy), the acquisition structure (including details on the financing) and the indicative purchase price and (ii) a binding offer after completion of the due diligence exercise, including the final purchase price, adjustments mechanisms, conditions precedent, representations and warranties and specific indemnities set out in the definitive purchase agreement usually attached as an annex to the binding offer.

A merger consists of the automatic transfer of all the assets and liabilities, by operation of law, of the absorbed company to the absorbing company. The liabilities are automatically assumed, as the case may be, under the terms and conditions specified in the merger contract. For a transaction to be characterized as a merger, the shareholders of the entity which contributes the assets must in principle receive shares from the entity receiving the assets but a limited cash payment is permitted in certain circumstances (in some cases, simplified regime may apply with no issuance of shares). However, most combinations with foreign groups take the form of a share purchase or exchange or, occasionally, a contribution of French assets in exchange for shares in a foreign company. As to EU companies, the Cross-Border Merger Directive, as implemented by French law, provides for specific rules and procedures to facilitate mergers between French and other EU member state companies.

The most common form of acquisition, especially for larger businesses, is the purchase of shares. Transfers of assets are generally preferred for the sale of smaller businesses. Mergers and contributions are more frequently used for internal reorganization purposes or in the case of strategic combinations of companies or businesses or joint ventures. Spin-offs are generally used when necessary to carve out a specific business to be sold from the overall activity of a seller.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

Companies setting up operations in France can choose from a range of corporate vehicles. The most common of those forms are: corporations (*sociétés anonymes*: SA); simplified corporations (*sociétés par actions simplifiées*: SAS); and limited liability companies (*sociétés à responsabilité limitée*: SARL).

What are the different types of limited liability companies?

Limited liability companies can take the form of any of the most common types of private companies as listed above. The shareholders' liability for the debts and obligations of the company is limited to the amount of their capital contributions.

The corporation (*société anonyme*: SA) is the most sophisticated type of French company and is most suitable for larger businesses, including companies listed on the stock exchange. The SA is required to have a minimum of two shareholders and a share capital of EUR 37,000. SA are managed either by a CEO (being a French natural person) with a board of directors or an executive committee with a supervisory board. The functioning of SAs is heavily regulated by law and corporate governance rules are strictly defined in the French commercial code.

The simplified corporation (*sociétés par actions simplifiées*: SAS) is suitable for holding companies and businesses requiring flexibility in organizing the corporate governance rules. The SAS is managed and represented by at least one president (French or foreign individual or corporate entity) and the by-laws can provide for general manager(s) to be empowered with the same powers as the president. A collective corporate governance body (similar to a board of directors) can also be created to control the management of the SAS . More generally, arrangements related to governance, rights attached to the shares and transfer of shares can be freely organized by the by-laws. It may not be listed on a stock exchange. No minimum share capital is required to incorporate a SAS which must have at least one shareholder. A SAS cannot be listed on a stock exchange.

The limited liability company (*sociétés à responsabilité limitée*: SARL) is a closed form of company commonly used for small structures or 'family' businesses. No minimum share capital is required to incorporate a SARL and the share capital of a SARL is split up into partnership shares (parts sociales). A SARL must have at least one shareholder. A SARL cannot be listed on a stock exchange. Shares are freely transferable between the shareholders, but approval of a majority of the shareholders holding at least half of the shares is required in the event of transfer of shares to a third party (unless the by-laws require a larger majority). A SARL is run by one or several managers, the number of which is set out in the by-laws. A manager may be a French or foreign national, and must be an natural person not an entity.

Is there a restriction on shareholder numbers?

A SA must have at least two shareholders, without any other restriction on shareholder numbers.

A SAS must have at least one shareholder, without any other restriction on shareholder numbers.

A SARL must have at least one and no more than 100 shareholders (French or foreign citizens or legal entities).

What are the key features of a share sale and purchase?

In a purchase of shares, the purchaser steps into the shoes of the seller and acquires the company with all of its assets and liabilities. It is therefore critical that appropriate representations, warranties and indemnities be included in any sale agreement.

What are the key features of an asset sale and purchase?

In the sale of a business as a going concern (known as a *fonds de commerce*), certain assets and contracts are deemed part of the transferred business (which essentially involves clientele, other intangible assets, tangible assets, employment contracts, insurance contracts and commercial leases). Any other assets or contracts to be transferred (e.g., real estate and other contracts) must be specifically identified, or else will be deemed assets to remain with the seller. All liabilities will be deemed to remain with the seller except:

- certain liabilities which are the subject of specific regulation (e.g., in relation to employees transferred with the business, social contributions or environment); and

- as otherwise provided in the business transfer agreement.

The sale of a business as a going concern will be subject to transfer tax.

The sale of a business as a going concern must comply with mandatory formalities and must be formalized in a business transfer agreement (for tax registration purposes, the business transfer agreement or a short form version needs to be executed in the French language). A notice of the transfer of the business must be published in a local legal gazette and in the BODACC (the national official bulletin for civil and commercial announcements) within 15 days from the date of the transfer. Creditors of the seller have 10 days from the notice (the opposition period) to object to the payment of the transfer price to the seller until the seller repays their debt.

If the business is carried out or situated in a specific protected area (*périmètre de sauvegarde du commerce et de l'artisanat de proximité*) i.e., a geographic area delimited by decision of the local municipality (local town administration) to protect local craftsmanship, commercial activities and diversity, the municipality has a right of pre-emption to acquire the business. Notice of the contemplated business transfer must be given in advance by the seller to the municipality. The municipality has two months from the date of receipt of the notification to exercise its pre-emption right to acquire the business. Failure to comply with this notification requirement may result in the transfer of the business being challenged by any interested third party and declared invalid by a court decision.

Finally, the seller of a business remains jointly liable with the buyer *vis-à-vis* third contracting parties unless it obtains the express written authorization of its co-contracting party releasing him from this joint and several liability following the transfer.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

In complex transactions, it is customary to prepare letters of intent or term sheets. They are not usually legally binding as the aim of the letters of intent or term sheets is to provide for the main terms and conditions of the prospective transaction, which remain subject to further negotiations between the parties. Provisions which are usually expressed as legally binding in the letter of intent include confidentiality, exclusivity and break-up fees.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: Exclusivity provisions are commonly used but only where a specific time frame for the exclusivity period is clearly set out.
- Break fee: Break fees are not common at all in France and constitute a penalty provision. Moreover, a judge would be entitled to reduce its amount should it be significantly higher than the real level of damage likely to be incurred.
- Confidentiality: Confidentiality provisions are very commonly used in term sheets.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Confidentiality or non-disclosure agreements ("**NDA**") are usually drafted as separately negotiated agreements (usually entered into by the parties before starting discussions on the transaction). Exclusivity and, if applicable, break fees are usually included in the term sheet if such agreement is binding, i.e., exclusivity will rarely be granted by the seller before a binding agreement is reached on the main terms and conditions of the transaction (in particular, within a bid process).

Is there a duty or obligation to negotiate in good faith?

The Civil Code provides for an express obligation on parties negotiating a transaction, including a sale of shares, assets or business, to negotiate in good faith. This duty applies both in pre-contractual negotiations and during performance of the contract. The duty includes the obligation to inform the buyer of relevant important facts that the buyer could not discover on its own. Also, where negotiations are at an advanced stage giving rise to a reasonable expectation that the transaction will proceed, the unilateral termination of the negotiations by a party may give rise to damages if such termination is characterized as unfair/wrongful.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: purchase price adjustments are fairly common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: choice of adjustment method generally depends on the calculation methods of the purchase price and the type of business operated by the target. Net debt (or net cash) and working capital adjustments are common. Net assets value adjustments are less common.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely. Collars are not common.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: buyer usually has responsibility to ensure target company prepares this, but the seller also taking responsibility is especially seen where the seller is continuing e.g., in owner-managed companies with earn-out arrangements.

Is the balance sheet audited (where applicable)?

Frequency/market practice: the closing balance sheet is rarely audited. Third-party experts are generally used, as designated by the parties, to review the closing balance sheet post-closing if there is a dispute between the parties regarding calculation of the purchase price adjustment (art. 1592, French Civil Code).

Is an earn-out common?

Frequency/market practice: rarely to fairly common, in circumstances where the sellers continue managing the target company after closing or, in case of a disagreement or the valuation of the target between the parties (in particular for start-up or tech companies for which the buyer may have difficulties to assess the "real" value for the target); otherwise fairly uncommon.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: fairly common, in circumstances where it is for the purpose of securing both the purchase price adjustment and the indemnification obligations of the seller under the representations and warranties, specific indemnification cases and breach of covenants. In addition, an escrow mechanism is often used under asset deals qualifying as transfer of going concerns (*cessions de fonds de commerce*) to secure the payment of the purchase price during the post-closing opposition period of the creditors.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Merger control clearance closing condition?

The parties cannot close until they have obtained merger clearance from the relevant competition authority. Thus, the insertion of a condition precedent regarding merger control clearance is necessary when the transaction is caught by merger control rules.

Foreign Investment prior authorization closing condition?

The parties cannot close until they have obtained Foreign Investment prior authorization (if applicable) from the MoE. Thus, the insertion of a condition precedent regarding Foreign Investment prior authorization is necessary when the transaction is within the scope of sensitive sectors caught by the foreign investment regime.

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common as the scope/definition of the MAE is often an issue and subject to negotiation.

Is the MAE general or specific?

Frequency/market practice: both are seen. Depending on the negotiations, the scope and definition of the MAE are key and often subject to negotiation.

Is the MAE quantified?

Frequency/market practice: rarely (even if sometimes seen in certain transactions).

Covenants

Is a non-compete common?

Frequency/market practice: non-compete is very common depending on the context. Non-compete provisions may rarely apply if the seller is an investment fund or if the seller and the target act within the same industry and market.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: waterfall/blue pencil provisions are not applicable in France.

Are non-solicitation provisions (of employees) common?

Frequency/market practice : very common depending on the context (see comments related to non-compete). Duration is generally similar to non-compete.

Are non-solicitation provisions (of customers) common?

Frequency/market practice: very common depending on the context (see comments related to non-compete). Duration is generally similar to non-compete.

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: rarely, there is a risk of de facto management by the buyer under French law.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: very common. Updating disclosure schedules and notification of a possible breach between signing and closing is very common. However, it is usually agreed that disclosure must not prevent or limit the buyer's right to indemnification. The buyer's right to walk away where there is a material update/breach between signing and closing may be negotiated (issues linked to MAE).

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common. Materiality qualifiers are commonly used but often not quantified (other than specific warranties e.g., contract value or representations regarding actions or events in the interim period).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are common and usually negotiated. Often limited to the actual knowledge of a limited group of persons including the management and individuals who handled the due diligence process on seller/target side.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common.

Is disclosure of the data room common?

Frequency/market practice: fairly common. Not systematic, but always negotiated.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: repetition of the representations and warranties at completion is very common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: repetition to make sure that representations and warranties have been true at all times between signing and closing is very common.

Is a bring-down certificate at closing common?

Frequency/market practice: bring-down certificates at completion are fairly common.

What is the applicable repetition standard e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: fairly common. True and accurate in all material respects is common but for fundamental representations it must be absolutely true. Often negotiated.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: 10%–30% for general cap. Key warranties may be subject to a different, greater cap than the general cap. Specific indemnities are usually capped at 100% and sometimes not capped.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: usually warranties only.

What are the common exceptions to the cap?

Frequency/market practice: key representations and warranties often excepted (e.g., title, ownership, authority, good standing, etc.) Often tax and specific areas of concern (treated as specific indemnities) depending on key findings in due diligence also expected with specific, separated caps or no cap.

Is a deductibleor basket common?

Frequency/market practice: both common (50/50).

Is a de minimis common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: from 12–36 months for general representations and warranties.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: for tax, social security and environmental matters or key representations and warranties/specific indemnities for which statute of limitations usually applies (+x months). Exception for breach of competition laws/compliance matters to be considered.

Is warranty insurance common?

Frequency/market practice: rarely but more and more frequent.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: fairly common.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: it is fairly common to provide for a representation from the buyer that, except as disclosed in the purchase agreement, it is not aware of any breach of representations at time of closing.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: choice of governing law allowed but generally accepted market practice that French law applies for French target companies.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: both are common (50/50). Arbitration common with foreign buyers/sellers and local courts are common with local buyers/sellers.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: stamp duty applies. Usually borne and paid by the buyer but shared payment can be negotiated (yet both parties remain liable for payment towards the French tax authorities). Stamp duties are equal to 0.1% of portion of purchase price paid to each seller for the transfer of shares in French corporations (SA) or French simplified corporations (SAS) and 3% of the portion of purchase price paid to each seller exceeding EUR 23,000 for the transfer of shares in French limited liability companies (SARL).

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: it is fairly common to have tax representations and warranties and specific indemnification included in the general representations and warranties. However, also common to have specific tax indemnity when a specific tax risk has been identified in the due diligence and specific indemnification period aligned on applicable statute of limitations for tax matters.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

Guide to Navigating Global Private M&A

Germany

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

Typical legal due diligence issues in Germany include commercial contracts (e.g., customer, supplier and distribution agreements), financing agreements (e.g., bank and shareholder loans), real estate (owned and leased), employment and pension matters, IP, IT, regulatory/public law, environmental law and litigation. In a share deal (but not typically in an asset deal), corporate matters are a main focus of the legal due diligence.

For quite some time, compliance issues, in particular relating to anti-bribery, corruption, money-laundering and competition law, have also received increased attention in due diligence exercises.

The legal due diligence is typically limited to a review of documents in a virtual data room, sometimes enhanced by expert interviews. For larger auction sales, it is common for a seller to provide a vendor due diligence report or a legal fact book as part of the information granted to bidders.

Issues identified in the due diligence are typically dealt with by (i) having them rectified by the seller before signing/closing (e.g., obtaining waivers from third parties if change-of-control provisions have been identified in commercial contracts), (ii) specific indemnities regarding specific known risks identified in the course of the due diligence (e.g., environmental risks, ongoing litigation), or (iii) general representations and warranties (e.g., existence and ownership of title to sold shares).

Independent appraisal

In a typical private M&A transaction (share deal or asset deal) where the purchase price is paid in cash (instead of shares), there is no statutory requirement to obtain independent appraisals. Nevertheless, the buyer's management will typically also conduct a financial due diligence in order to determine the purchase price. In this context, it is common to involve third-party financial advisers to obtain a valuation of the target or a fairness opinion. For German buyers, this is mainly done to comply with management duties. The management of a German company has a general duty to justify its decision for an acquisition and the amount of purchase price paid for the target.

Independent appraisals may be required where the purchase price is not paid in cash as well as other types of corporate transactions, such as capital contributions in kind and/or reorganizations pursuant to the German Transformation Act.

Payment

There are generally no restrictions regarding the pricing or the payment of the purchase price from a legal perspective. Most commonly, the purchase price is paid in euro. However, a payment in other currencies or a consideration by way of shares is also possible. If the purchase price does not reflect the fair market value, this may have tax consequences.

Signing/closing

Share sale

The sale of shares in a German limited liability company ("**GmbH**"), which is the most common acquisition structure in Germany, requires the share purchase agreement ("**SPA**"), including all exhibits and annexes, to be notarized by a German notary. Notarization is formalistic and somewhat cumbersome, since all parties have to be present at the notary appointment (either in person or by proxy based on a power of attorney), and the whole SPA has to be read aloud by the notary. The statutory notary fees triggered by the notarization depend on the value of the transaction, and can be quite significant.

SPAs relating to shares in other types of companies (e.g., stock corporations or partnerships) generally do not require notarization and may be entered into by simply signing the SPA.

Asset sale

An asset sale does not typically require any notarization, unless the sold assets include owned real estate or the seller is selling all or almost all of its assets. An asset purchase agreement ("**APA**") is typically more extensive and detailed, because it has to specify all individual assets, liabilities, contracts, employees, etc. that make up the sold business. Particularly with regard to tangible assets, German law requires an exact specification of the assets in the APA or an exhibit.

Buyers who do not have a German entity that can acquire the assets making up the sold business usually set up a special purpose vehicle that acts as buyer and conducts the German business operations going forward.

Closing

In most cases, signing and closing do not occur simultaneously because of the required merger clearance (see below). Therefore, a separate closing has to take place. At the closing, the actual share transfer takes place and the purchase price is paid. Often, the SPA or the APA also provides for other closing conditions and closing actions.

Approvals/registrations

Foreign investment

As a result of the security concerns raised by the latest trend of foreign investments into domestic companies (e.g., multibillion acquisitions of Energy from Waste ("**EEW**") by Beijing Enterprises and of Kuka by the Chinese Media Group), Germany has strengthened and continues to strengthen its foreign investment review laws through a number of consecutive reforms. A reform of the foreign investment restrictions in 2018 reduced the threshold for review from acquisitions of 25% of a company's voting rights to acquisitions of 10% for particularly sensitive target companies. In addition, the reform added media companies to the list of particularly sensitive companies to which the 10% threshold applies. In 2019, the EU enacted Regulation (EU) 2019/452 (EU Screening-Regulation), which will enter into force in October 2020, and will create a common EU-wide regulatory framework on foreign investment review. Among other coordination efforts, it obliges EU member states to take the impact of foreign investments on other EU member states into account when reviewing foreign investments. Currently, Germany is in the process of implementing the EU Screening-Regulation.

In Germany, foreign investment reviews fall into two categories: sector-specific and cross-sector reviews.

The sector-specific review applies to any acquisition of at least 10% of the voting rights in a German company by any investor located outside of Germany if the target produces or develops highly sensitive products such as war weapons, engines and gears for the drive of battle tanks, security relevant IT products, as well as sensor and crypto technology. Companies operating in these sectors are subject to a mandatory approval of the acquisition.

The cross-sector reviews apply to all acquisitions that can raise concerns in relation to public order or security. The German Federal Ministry for Economic Affairs and Energy (*Bundeswirtschaftsministerium*) can investigate and ultimately restrict or prohibit any acquisition of at least 10% or 25% of the voting rights in a German company by an investor located outside the EU/European Free Trade Association ("**EFTA**") depending on the type of company. The 10% threshold applies to particularly sensitive companies, such as those operating critical infrastructure or sensitive digital technologies, but also includes certain media companies. Industries such as energy, information technology and telecommunication, transport and traffic, health, water supply, nutrition, finance and insurance sectors are classified as "critical infrastructures." The catalogue of particularly sensitive companies was recently extended to include companies in the healthcare sector, e.g., companies which develop or manufacture personal protective equipment.

For all acquisitions by non-EU/EFTA purchasers that belong to the sectors specifically referenced in the catalogue, the *Bundeswirtschaftsministerium* has to be notified about the acquisition. Non-listed sectors do not fall under a mandatory notification requirement, but can still be subject of an FIR.

According to a law recently passed by the German parliament, the evaluation benchmark for investigation within the scope of the cross-sector review will be lowered to foreign investments having a probable adverse effect (*voraussichtliche Beeinträchtigung*) on the public order or security of Germany or another EU member state.

To obtain legal certainty, the investor can apply for a certificate of non-objection issued by the *Bundeswirtschaftsministerium*. A certificate of non-objection, also called a clearance certificate, is a binding confirmation that the acquisition does not raise any concerns regarding public order or safety. The *Bundeswirtschaftsministerium* has two months to issue a clearance certificate following the application by the acquirer. The clearance certificate is considered to be granted if the *Bundeswirtschaftsministerium* fails to open an investigation in that period of time.

For foreign investors, the new rules will increase the regulatory burdens involved in the M&A process. Germany has tightened its foreign investment rules several times over the last few years. Securing a clearance certificate will be even more important in the future since it will provide legal certainty to the acquirer.

German merger control

In Germany, the following transactions are considered to be a concentration and hence subject to German merger control law:

- the acquisition of all or a substantial part of assets of the target company
- the acquisition of sole or joint control with regard to the target company
- the acquisition of shares if the shares reach (i) 50% or (ii) 25% of the capital or the voting rights concerning the target company
- any other combination of undertakings enabling one or several undertakings to exercise directly or indirectly a material competitive influence on another undertaking

In contrast, under European merger control law, a concentration only includes transactions that imply a lasting change of control, i.e., the mere acquisition of a minority share, for instance, does not trigger merger control requirements if no change of control takes place.

A concentration has to be notified to the Federal Cartel Office (*Bundeskartellamt*) if in the last business year preceding the concentration:

- the combined aggregate worldwide turnover of all the undertakings concerned was more than EUR 500 million;
- the domestic turnover of at least one undertaking concerned was more than EUR 25 million; and
- the domestic turnover of another undertaking concerned was more than EUR 5 million,

unless a standalone undertaking with a worldwide turnover of less than EUR 10 million in the business year preceding the merger engages in a concentration with another undertaking.

To avoid merger control gaps, Germany recently added a transaction-value-based threshold whose requirements are fulfilled if:

- the combined aggregate worldwide turnover of all the undertakings concerned was more than EUR 500 million;
- the domestic turnover of at least one undertaking concerned was more than EUR 25 million;
- the domestic turnover of no other undertaking concerned was more than EUR 5 million;
- the value of consideration paid in return for the concentration is more than EUR 400 million; and
- the target company is significantly active in Germany.

The German Federal Ministry of Economics and Technology has proposed to raise the standard turnover threshold and to introduce that the *Bundeskartellamt* may by order require an undertaking to notify any merger of that undertaking with other undertakings in one or more specific sectors of the economy if certain thresholds are met. The changes are expected to enter into force in the second half of 2020. Please refer to the Antitrust section for further information on the planned changes.

The German provisions do not apply if the European Commission has jurisdiction. Under European law, a concentration needs to be notified to the European Commission if it has a Community dimension, i.e., if it meets the following thresholds in the last business year preceding the concentration:

- the combined aggregate worldwide turnover of all the undertakings concerned was more than EUR 5,000 million; and
- the aggregate EU-wide turnover of each of at least two of the undertakings concerned was more than EUR 250 million,

unless each of the undertakings concerned achieves more than two-thirds of its aggregate EU-wide turnover within one and the same Member State.

If the first set of thresholds described above is not met, there is a subsidiary set of thresholds when a concentration can have a Community dimension:

- the combined aggregate worldwide turnover of all the undertakings concerned was more than EUR 2,500 million;
- in each of at least three Member States, the combined aggregate turnover of all the undertakings concerned was more than EUR 100 million;
- the aggregate turnover of each of at least two undertakings concerned in each of at least the three Member States mentioned above was more than EUR 25 million; and
- the aggregate EU-wide turnover of each of at least two undertakings concerned was more than EUR 100 million,

unless each of the undertakings concerned achieves more than two-thirds of its aggregate EU-wide turnover within one and the same Member State.

The German merger control process consists of one or two phases depending on the complexity of the concentration. After the concentration has been notified, the *Bundeskartellamt* has one month either to clear the concentration or to initiate Phase II (Phase I). In Phase II, the *Bundeskartellamt* further examines the concentration and either clears or prohibits it. If the undertakings concerned do not receive the decision of the *Bundeskartellamt* within four months post-notification of the concentration, it is deemed to be cleared. This time limit shall be extended by one month if, for the first time during the proceedings, a notifying undertaking submits remedies to the *Bundeskartellamt*.

The undertakings concerned may not implement a concentration unless (i) it has been cleared by the *Bundeskartellamt* or (ii) the above time limits have expired. Any implementation measure prior to the notification or failure to notify can be fined by the *Bundeskartellamt* by up to 10% of the worldwide aggregate turnover of the undertaking concerned.

During the review of the concentration by the *Bundeskartellamt*, the relevant market as well as the market shares and market power of the undertakings concerned need to be analyzed (e.g., with economical tools, such as the SSNIP-test (small but significant and non-transitory increase in price)).

If the undertakings concerned have high market shares and the concentration therefore raises competition concerns, to meet the competitive concerns of the *Bundeskartellamt*, the undertakings can offer certain commitments, e.g., divest a business to a suitable buyer, to secure effective competition.

Employment

Share deal: In share sales, there is no change in the employer/employee relationship. Neither consent from employees nor notices to employees are required. However, an economic committee or, in the absence of such committee, the works council of the entity to be sold needs to be notified in advance of the contemplated sale.

Asset deal: In an asset sale that involves the transfer of a business (or part of a business) as a going concern, employees belonging to the business automatically transfer to the buyer by operation of law, and the parties to the transfer of business are not free to choose which employees will transfer with the business. Employees have a right to object to their transfer within one month from the time they are duly informed about the transfer. This information has to be provided in text format and is subject to strict requirements.

Terms and conditions of employment in principle have to remain unchanged after the transfer and the new employer by law has to recognize the employees' years of service. The buyer as the legal successor of the former employer also becomes fully liable for all employment-related liabilities. Compensation for the automatic assumption of liabilities should be addressed in the transaction documents.

There is no general legal obligation to consult with works councils or the employees regarding the asset deal and the transfer of the employees. However, reorganizations and operational changes that need to be implemented in conjunction with the transaction (e.g., split of operations, carve-outs of employees, relocations) typically trigger consultation obligations. Consultations may take several months and, thus, may significantly impact the timing of the implementation of the respective reorganizations or operational changes. Terminations "due to a transfer of business" are prohibited by law. Terminations for other reasons (e.g., based on a separate restructuring decision) remain possible.

Pension schemes and the transfer of pension liabilities need to be considered carefully in the transaction context.

Tax

Asset deal

The capital gains of a foreign corporate seller with a German permanent establishment are principally subject to corporate income tax ("**CIT**") and solidarity surcharge ("**SolS**") at a consolidated rate of 15.83% and trade tax ("**TT**") at rates usually between 7% and 17%.

For a buyer, in an asset deal, the acquired tangible and intangible assets, including goodwill, attributable to a German permanent establishment are capitalized at acquisition costs on the basis of a purchase price allocation, often leading to a step-up of the tax basis and increased depreciation/amortization basis. Special tax valuations and accounting rules exist if liabilities are transferred to the buyer.

The transfer of assets/liabilities by way of an asset deal involving the transfer of a business (or part of a business) as a going concern will typically not be subject to VAT. If no going concern business is transferred, the transfer of assets/liabilities within an asset deal is principally subject to VAT. If German property is transferred, real estate transfer tax ("**RETT**") might apply.

Due to the "transparency" of German partnerships for income tax purposes, the acquisition of an interest in a partnership is treated similarly to a sale of the partnership's assets.

Share deal

The capital gains of a corporate seller in the case of a sale of shares in a corporate entity (share deal) are principally tax exempt under German domestic law, but 5% of the capital gain is treated as a non-deductible business expense, leading to a consolidated tax burden equal to approximately -1.5% of the capital gain. In the case of a foreign corporate seller, it can be argued on the basis of recent case law that the capital gain is entirely exempt from German taxation. Moreover, under applicable double tax treaties, Germany usually does not have a right to tax such capital gain realized by a foreign seller at all, provided that the seller does not have a permanent establishment in Germany. Special rules may apply for the sale of real estate rich companies.

Loss carryforwards and other tax attributes available at the level of the target company before the acquisition may no longer be usable after closing due to loss forfeiture regulations.

The sale and transfer of shares is generally not subject to VAT, unless the exemption is waived. If shares in a company holding German real estate are transferred, RETT might be triggered.

Post-acquisition integration

After the acquisition has been completed, the target business needs to be operationally and/or structurally integrated into the buyer's existing structure.

As part of the operational integration, the buyer typically needs to identify the target's ability to operate and conduct its business after its owner has changed. To transition the business, it may be necessary for the seller to provide to the target and/or the buyer certain transitional services for a certain period of time (e.g., IT services, rental agreements, supplies). During the due diligence phase, the buyer should already closely consider if and to what extent it will be necessary for the seller's group to provide certain transitional services in order to ensure the buyer's ability to continue the acquired business.

With regard to the integration of the target or the target group into the buyer's corporate structure, the German Transformation Act provides for various corporate reorganizational measures such as merger, split, spin-off and hive-down. In addition, it is common to contribute and/or distribute assets and/or shares. The steps are mainly determined by tax considerations both in Germany and abroad in the case of cross-border group structures. In addition, there are typically integration steps required from an employment law and pensions perspective when acquiring larger organizations.

Common deal structures

What are the key private M&A deal structures?

The acquisition of a German company or business is typically structured as a purchase of shares or a purchase of assets. In addition, the German Transformation Act and general corporate law provide for alternative structuring possibilities for acquisitions (e.g., mergers). The most common acquisition method in Germany is the purchase of shares. A purchase of assets is, in most cases, more complex and time-consuming, and therefore less frequent. Another reason for sellers preferring a share deal is the fact that it is generally more tax-favorable for the seller.

Auction processes are very common in Germany. Such processes are typically administered by investment banks or other financial/M&A advisers, who put together the teaser, information memorandum and virtual data room, and organize procedural matters by way of process letters. In the course of the auction process, the bidders are initially requested to submit non-binding indicative bid letters and, at a later stage, so-called binding bid letters as well as a markup of seller's draft SPA. Although referred to as binding bids, from a German law perspective such bids may still be non-binding if the target is a GmbH. The obligation to purchase shares in a GmbH requires notarial recording of the agreement. Since the bid letters typically are not notarially recorded, the obligation to purchase the shares at the offered price cannot be enforced. It is therefore common that final negotiations take place with more than one bidder after the bidders have submitted the final bids.

The German Transformation Act governs mergers and divisions of legal entities. A merger is the combination of at least two legal entities by way of transferring all assets and liabilities of the transferring entity, the transferor, to the receiving company, the transferee. The act distinguishes between two basic types of merger: merger by acquisition and merger by the formation of a new company. In the first case, the transferee already exists while in the second case the transferee will be established by the merging transferors. The interest holders of each transferor receive shares or memberships in the transferee in return for shares or memberships in the transferor being dissolved by the merger.

A division is the split of a legal entity by transferring certain parts of its business (i.e., assets and liabilities, contracts, employees, etc.) to a receiving company. The act distinguishes between three basic types of division:

- the split;
- the spin-off; and
- the hive-down.

Each of these types of division can be effected by acquisition or the formation of a new company.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

The most popular forms of incorporated entities are the limited liability company (Gesellschaft mit beschränkter Haftung, GmbH) and the stock corporation (Aktiengesellschaft, AG). Both are legal entities that provide limited liability for their shareholders. In general, when conducting business through one of these two corporate bodies, only the company's assets are accessible by the creditors of the company to satisfy their claims. In return, the establishment of both entities requires a certain minimum capitalization.

The GmbH is the most common vehicle through which to conduct business, and it almost suits all kinds and sizes of operation. Its governing regime, the German Limited Liability Company Act ("***GmbHG***"), does provide the shareholders with broad possibilities as regards the arrangement of the entity's organization. Due to its flexibility, it is widely accepted among small and medium-sized corporations.

What are the different types of limited liability companies?

The vast majority of German companies exist in the form of a limited liability company ("**GmbH**"). However, German law also offers a number of other legal forms, including stock corporations ("**AG**") and partnerships (Personengesellschaften). German limited liability companies (Gesellschaft mit beschränkter Haftung/GmbH) are regulated by the Limited Liability Company Act. They may be formed by one or more shareholders. The minimum share capital of a GmbH is EUR 25,000. Beyond the duty to pay in the share capital subscribed for, the shareholders are in principle neither liable for obligations of the GmbH nor required to pay in any additional share capital.

The corporate governance of the GmbH is structured as a two-tier system, consisting of one or more managing directors on the one hand and the shareholders' meeting on the other hand. Such a two-tier structure, however, is not mandatory. The articles of association may provide for the existence of a third tier, such as a supervisory board or an advisory board. Sometimes, the existence of a supervisory board is mandatory, e.g., if the GmbH has more than 500 or more than 2,000 employees. Such mandatory supervisory boards then have to have a ratio of employee representatives on the board.

The managing directors are responsible for the management of the company and its representation vis-à-vis third parties. Their signatory power is unlimited vis-à-vis third parties and can only be restricted by granting a joint signature power to be exercised together with another managing director or a registered representative (*Prokurist*). In addition, it is possible to implement internal restrictions, such as approval requirements regarding certain transactions. However, such restrictions generally do not apply vis-à-vis third parties, who may rely on the managing director's unrestricted signatory power unless they are aware of any internal restrictions.

In spite of the rather far-reaching powers of managing directors, the ultimate authority in a GmbH without a mandatory supervisory board remains with the shareholders, who are entitled not only to collectively decide on the appointment and removal of the managing directors but also to instruct them on all issues relative to the management of the company. Further, the shareholders' meeting has competence to make decisions for the company with regard to certain fundamental issues provided for by law or the articles of association, such as the amendment of the articles of association, an increase or decrease of stated capital, the use of profits, liquidation or transformation of the company, etc. Nevertheless, the shareholders do not have authority to represent the GmbH vis-à-vis third parties.

Is there a restriction on shareholder numbers?

Both in a German limited liability company (GmbH) and stock corporations (AG), there can be one or several shareholders. With respect to partnerships, the number of partners needs to be at least two.

What are the key features of a share sale and purchase?

By acquiring all of the shares or partnership interests in a legal entity, a purchaser acquires any and all rights associated with the ownership of the shares or partnership interests. In particular, this includes the right to control the legal entity and to receive profits generated by it. At the same time, the purchaser indirectly (as new owner of the legal entity) acquires all liabilities and risks associated with the legal entity.

Since the change in ownership of the shares or partnership interests occurs only on shareholder level, the legal entity as such and its business will not change as a result of the acquisition.

The sale of shares in a German limited liability company (GmbH), which is the most common acquisition structure in Germany, requires the SPA, including all exhibits and annexes, to be notarized by a German notary. SPAs relating to shares in other types of companies (e.g., stock corporations or partnerships) generally do not require notarization and may be entered into by simply signing the SPA.

What are the key features of an asset sale and purchase?

German law does not provide for specific regulations regarding the sale and transfer of a business as a going concern. Instead, each asset must be sold and transferred individually. In particular, with respect to the transfer of ownership, it is important to observe the statutory requirements regarding the different types of assets that make up the business being sold.

Although the liabilities and risks of an acquired business generally do not transfer to the purchaser unless specifically provided for in the asset purchase agreement, there are circumstances under which a purchaser may become liable for the obligations of the previous owner of the business. This will be the case, for example, where an acquired business is carried on under the previous company or trading name of the seller (s. 25, HGB). Such assumption of liabilities by operation of law can be avoided by an agreement between the seller and purchaser, which becomes effective vis -à-vis third parties when published in the Federal Gazette and registered in the commercial register.

An asset sale does not typically require any notarization, unless the sold assets include owned real estate or the seller is selling all or almost all of its assets. An APA is typically more extensive and detailed, because it has to specify all individual assets, liabilities, contracts, employees, etc. that make up the sold business. In particular, with regard to tangible assets, German law requires an exact specification of the assets in the APA or anexhibit.

Buyers who do not have a German entity that can acquire the assets making up the sold business usually set up a special purpose vehicle that acts as buyer and conducts the German business operations going forward.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

Pre-contractual obligations may also become relevant in the case of breaches of exclusivity or the abandonment of negotiations. A seller that pretends to have an interest in selling to a buyer or breaches its exclusivity undertaking may become liable for that buyer's expenses incurred up until that point (due diligence, etc.) if the sale to the buyer ultimately does not take place. This may apply even if the parties have signed a non-binding letter of intent, term sheet, memorandum of understanding or similar 'pre'-agreement. However, it is usually difficult for a purchaser to prove that the seller breached its pre-contractual obligations to negotiate in good faith. Therefore, buyers have an interest in requesting a breakup fee or liquidated damages in the letter of intent to forestall such an eventuality.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

– Exclusivity: Exclusivity of negotiations is one of the provisions typically covered in term sheets and letters of intent.
– Break fee: Breakup fees are not very common, but they are sometimes agreed, particularly in the event that a party will need to incur significant costs to progress negotiations up to the point of entering into a transaction.
– Confidentiality: Confidentiality is one of the provisions typically covered in term sheets and letters of intent.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Separate confidentiality agreements or non-disclosure agreements are very common. Typically, a confidentiality agreement is entered into at the outset and then, at a later stage, the term sheet or letter of intent makes reference to the initial confidentiality agreement already in place.

Is there a duty or obligation to negotiate in good faith?

Under German law, there is a general pre-contractual duty to negotiate in good faith. Accordingly, each party may become liable vis-à-vis the other party for damages caused by a breach of their pre-contractual duties.

Such pre-contractual duties include quite far-reaching information and disclosure duties on the part of the seller. In an M&A transaction, sellers are generally obliged to inform purchasers of all material issues and circumstances that they are aware of if they can generally, and from an objective perspective, be regarded as relevant to a buyer's purchase decision. A disclosure duty certainly applies if a purchaser asks the seller specific questions (e.g., in the due diligence process). If such disclosure duty is breached intentionally during the negotiations, the purchaser may be entitled to claim damages from the seller over and above any damages or limitations of liability provided for in the purchase agreement. This is because it is generally not possible to limit or cap a party's liability for intentional behavior. Further, if the non-disclosure constitutes fraud on the part of the seller, the buyer may be entitled to rescind the purchase agreement.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: fairly common; sellers often try to push for a locked-box structure with no post-closing adjustment.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: common adjustments are cash-free debt-free adjustments as well as working capital.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely; collars are not common.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: in a seller's market, this is usually prepared by the seller; in a buyer's market, it is usually prepared by the buyer.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely; closing balance sheets are not necessarily audited; this depends on the circumstances.

Is an earn-out common?

Frequency/market practice: rarely; it is uncommon for larger deals, but sometimes seen in mid-cap deals with private individuals as sellers.

Is a deposit common?

Frequency/market practice: rarely; not at all.

Is an escrow common?

Frequency/market practice: fairly common; whether an escrow is requested by a purchaser depends on the seller. Where large corporations act as the seller, an escrow is typically not requested.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common.

Is the MAE general or specific?

Frequency/market practice: both are seen.

Is the MAE quantified?

Frequency/market practice: fairly common; sometimes seen as a reference to sales or EBITDA effect.

Covenants

Is a non-compete common?

Frequency/market practice: very common; typically, these relate to the distribution of proceeds/assets in an exit event (less common are dividend preferences).

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: very common; waterfall provisions are very common in private equity/venture capital companies.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common; these are common in international transactions (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: rarely used in national transactions.

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common; competition law restrictions regarding so-called gun-jumping need to observed when drafting these restrictions. The purchaser's control and influence on the target prior to merger clearance must be limited.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; generally yes in private transactions, but avoiding a set-up that could be interpreted as taking over control of the target.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: rarely.

Representations and warranties

Materiality in representations — How is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen but are often not quantified (other than specific warranties, e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: this is often limited to the actual knowledge of or due enquiry of a specified list of senior management/deal team.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: rarely.

Is disclosure of the data room common?

Frequency/market practice: very common.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common; repetition at completion for some warranties (e.g., title, capacity) is standard. Repetition of operational warranties at completion and bring-down certificates are difficult to get in a seller's market.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: fairly common; repetition at completion for some warranties (e.g., title, capacity) is standard. Repetition of operational warranties at completion and bring-down certificates are difficult to get in a seller's market.

Is a bring-down certificate at closing common?

Frequency/market practice: bring-down certificates are difficult to get in a seller's market.

What is the applicable repetition standard, e.g., true in all material respects or material adverse effect?

Frequency/market practice: fairly common; true and accurate in all material respects is common but often carve out for fundamental representations which must be absolutely true.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: the common cap amount is typically between 10%–25%. Title to shares is often capped at the amount of the purchase price.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: the lower (operational) cap generally applies to operational warranties and damage claims. However, the higher (overall) cap and other limitations typically apply to all claims under the agreement with certain exceptions, such as tax or leakage (in the case of locked-box) indemnity claims.

What are the common exceptions to the cap?

Frequency/market practice: key warranties (e.g., title), typically, tax and environmental indemnities and other specific indemnities are excluded from the lower cap but are often subject to a higher overall cap. Staggered caps are common.

Is a deductible or basket common?

Frequency/market practice: very common; both are common.

Is a de minimis common?

Frequency/market practice: very common.

How long does seller liability survive?

Frequency/market practice: a general survival of one full accounting cycle after completion, i.e., 18 months, is common. There are typically longer periods for title.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: fraud is carved out. Tax is commonly longer than general warranties, as well as environmental indemnities.

Is warranty insurance common?

Frequency/market practice: fairly common; warranty insurance is common, particularly when private equity is selling.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common; common for actually received.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common; common for actually received.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: very common; this is required by law.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: very common.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: German law.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is more common, and can take place in Germany or sometimes Switzerland.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: no stamp duty is payable. Notarization fees for the transfer of shares in a limited liability company are paid by the buyer.

Is a separate tax covenant / indemnity or tax deed common?

Frequency/market practice: very common.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

Baker McKenzie.

Guide to Navigating Global Private M&A

Hong Kong

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

Due diligence investigations remain an essential tool for assessing and reducing the risks inherent in a merger and acquisition transaction in Hong Kong. In the absence of complete knowledge of the operations, scope of assets and extent of liabilities of the target, due diligence investigations give the prospective buyer an opportunity to assess the target's legal and financial state of affairs. They also facilitate consideration of structuring issues. Accordingly, thorough due diligence is vital in most merger and acquisition transactions in Hong Kong.

Pricing and payment

There are no requirements to carry out a valuation or follow a particular valuation model for determining the purchase price for companies or assets in Hong Kong. However, particularly where the transaction is made between related parties, it is advisable to ensure that the transaction is conducted on arm's length terms to manage any potential transfer pricing and other legal issues, such as those related to a transfer at an undervalue. In practice, commonly used valuation methods include using a debt-free, cash-free basis (representing the enterprise value of the business), and using a locked box structure in competitive situations. The parties may also agree on an adjustment to the purchase price, based on any shortfall or excess of the target's actual working capital against a target working capital.

Hong Kong applies no controls on the movement of foreign exchange. Similarly, there are no restrictions on investment or repatriation of capital or remittance of profits or dividends to or from a Hong Kong company and its shareholders.

Signing/closing considerations

Is a deposit required?

The payment of deposits is not common practice in Hong Kong, except in the real estate sector. However, the buyer may be required to provide proof of funding.

Is simultaneous signing/closing common?

It is common for signing and closing to occur simultaneously in Hong Kong. However, where it is necessary to obtain regulatory or other consents or approvals before closing, or for the buyer to complete further due diligence after signing the agreement, then a split signing and closing will occur, which is also common in Hong Kong.

Approvals/registrations

Foreign investment

Hong Kong remains one of the least regulated jurisdictions in Asia. At present, no investment approval requirements are directed specifically towards foreign investors (other than limited industry-specific regulations). In addition, as a general rule, there are no restrictions on the levels of foreign ownership of Hong Kong companies.

Merger control (antitrust/competition approval)

Hong Kong's Competition Ordinance came into force on 14 December 2015, introducing cross-sector competition law in Hong Kong for the first time. The Competition Ordinance has two key prohibitions: (i) the First Conduct Rule, which prohibits anticompetitive agreements, arrangements and concerted practices (applying to both horizontal and vertical arrangements); and (ii) the Second Conduct Rule, which prohibits abuse of a substantial degree of market power.

The Competition Ordinance does not include any general merger control provisions, except for merger rules that already apply to the telecoms industry. The rules under this Ordinance are substantially similar to those already in force, though they clarify that indirect or overseas transactions involving telecommunication or broadcasting licensees and minority acquisitions fall within the scope of the Hong Kong regime. In addition, under the Competition Ordinance, merger activities are specifically excluded from the application of the First Conduct Rule and the Second Conduct Rule.

Other regulatory or government approvals

For certain sectors, such as banking, insurance, financial services and broadcasting, consent is required from the relevant regulatory body for: (i) a change of ownership; (ii) the acquisition of even a minority interest; or (iii) the disposal or amalgamation of the regulated business. With only a few exceptions, these merger approvals apply equally to foreign and local investors.

In the broadcasting industry, approval is required under the Broadcasting Ordinance if foreign ownership of a domestic free television program service licensee is to exceed certain thresholds: 2%, 6% and 10%. There is upcoming legislative reform that will relax this restriction against foreign control of domestic free television program services. A bill that will change the threshold percentages has been gazetted, but the bill has not yet been passed and there is currently no anticipated timeline as to when the amendments in the bill may come into force.

Foreign ownership of a radio broadcasting company must not exceed 49% as regulated under the Telecommunications Ordinance, and certain telecommunications licenses may only be issued to Hong Kong companies (although there are no restrictions on foreign ownership of such companies).

Employment

Where a transaction takes the form of an acquisition of shares in a company with employees, there are unlikely to be significant employment law issues, as the underlying employment contract (and employee benefits generally) between the target and its employees will usually be unaffected by the change in control. The contracts of key senior personnel should be checked, in particular, for any change of control provisions. Due diligence should be undertaken to ensure that potential liability for past acts and omissions is known.

The position is a little more complex in a transfer of the assets comprising a business, as the contracts of the business's employees are not automatically transferred to the buyer. Existing employment contracts must be terminated and new contracts should be entered into with the buyer. Technically, the employees will be made redundant by the transfer and it is important from the seller's perspective, to take steps, to the extent possible, to minimize the existing employer's potential liability to make payments to employees in this situation.

In order to avoid liability to pay severance to employees on the transfer of a business, the offer of new employment must be given by the buyer at least seven days before the date of the employees' transfer. The new terms of employment must either be identical to those under the employees' existing employment or constitute an offer of suitable employment on terms no less favorable to the employees than those under which they were previously employed. The new employer must agree to recognize the employees' previous period of service. It is common practice for the termination and offer of new employment to be combined in a joint letter sent by both seller and buyer, or to be made in separate letters from the seller and buyer, but given to employees at the same time. Typically, a clause requesting the employee's consent to a shorter contractual notice for the transfer will also be contained in the transfer letter. The notice period cannot, however, be shorter than seven days.

If, on a transfer of assets or business, the employees are provided with due notice and all the mandatory details they should receive (as above) but the employees decide not to accept the offer from the buyer and their employment is terminated by the seller, the legal exposure of the seller will, in normal circumstances, be limited to just a long-service payment (if applicable) plus accrued wages and untaken annual leave. If the employees are entitled to a contractual bonus, a pro rata portion may also be payable.

Tax

Transfers of shares in Hong Kong companies are subject to stamp duty. Stamp duty is currently calculated at a rate of 0.2% of the value of the shares or the purchase price paid, whichever is greater. The seller and buyer are each liable to pay stamp duty at 0.1% (hence the aggregate of 0.2%). However, the parties may contractually agree that the overall stamp duty shall be shared between them on a different basis.

The transfer of assets in Hong Kong may be subject to Hong Kong profits tax depending on the nature of the assets being transferred.

Gains on the disposal of a capital asset are exempt from profits tax. However, to the extent that the capital asset is a depreciable asset, any income arising from the claw-back of depreciation or capital allowances may be assessable. Income arising from the disposal of inventories or assets held for trade is assessable. That said, profits tax is only chargeable where the gain is derived from a Hong Kong source through the operation of business (in other words, an offshore-sourced profit or gain is not assessable). Whether a profit is Hong Kong-sourced will be determined on the basis of the location of the operations generating profit.

Post-acquisition integration

Buyers are realizing that the real challenge when acquiring a new business starts only when the deal closes and are focusing more on how to derive value from their acquisitions. Where the existing and target businesses operate in the same or complementary fields, the acquirer almost always wants to integrate the two businesses in order to save costs and develop synergies. It is important to plan for post-acquisition integration well in advance of closing.

Common deal structures

What are the key private M&A deal structures?

As in other jurisdictions, the acquisition of a business in Hong Kong may be structured either as a sale of shares or as a sale of assets (or a combination of the two). Particularly, the buyer may purchase the shares in the company operating the business from its shareholders or purchase the assets of the business directly from that company.

Auction processes are quite common in Hong Kong. They often involve a two-stage bid process, using non-binding bid letters at the indicative offer stage and binding bid letters at the final offer stage.

Broadly defined, a merger involves the absorption of one company (that ceases to exist) into another that retains its own identity and acquires the assets and liabilities of the former. Hong Kong provides for a simple, court-free amalgamation procedure for effecting the merger of Hong Kong companies as long as the companies are sister companies or parents-subsidiaries and the statutory requirements can be satisfied. Complex amalgamations may be effected through a court-sanctioned scheme of arrangement, though this is rarely used in practice. The court-free amalgamation procedure was introduced in March 2014 and the authorities have since provided guidance on the treatment of key elements, such as tax and employees. Where the legal position is unclear (e.g., whether employees transfer automatically), a more conservative approach is recommended. The economic results of a merger can also be achieved through:

- transfer of one company's business assets to another company, followed by liquidation or disposal of the transferor company;
- establishment of a new company that acquires the assets of two or more entities, which, following the transfer of assets, are liquidated or disposed of; or
- transfer of one company's (Company A) shares to another company (Company B), followed by liquidation of Company A and distribution of its assets in their present form to Company B.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

The most commonly used private company is a company limited by shares incorporated in Hong Kong under the Companies Ordinance (Chapter 622 of the Laws of Hong Kong). A company formed under Hong Kong law may be either limited, by shares or by guarantee, or unlimited. A company limited by shares can be either public or private. The usual form of a subsidiary company is a company limited by shares. If a company is limited by shares, the liability of its members (the term for "shareholders") is limited to the amount, if any, unpaid on their shares. Such a company can be formed quickly and requires little formality. Certain restrictions are imposed on a private company. Its articles of association must contain a restriction on the right of members to transfer their shares, limit the number of members to 50 (exclusive of any member who is a current or past employee) and prohibit invitations to the public to subscribe for the shares or debentures of the company. However, a private company may be converted into a public company at any time by removing these restrictions from its articles of association.

What are the different types of limited liability companies?

Limited liability companies in Hong Kong no longer have authorized capital, which limits the capital of the company (although companies can in their articles of association specifically limit the number of shares to be issued), and shares no longer have a par value. A company may not have bearer shares. The capital of a company may be denominated in any currency.

Is there a restriction on shareholder numbers?

Certain restrictions are imposed on private companies. Their articles of association must contain a restriction on the right of members to transfer their shares, limit the number of members to 50 (exclusive of employee members) and prohibit invitations to the public to subscribe for the shares or debentures of the company.

What are the key features of a share sale and purchase?

A share acquisition is generally more simple to implement from both the seller's and the buyer's point of view. A share acquisition involves the transfer of ownership of only the shares in the target company and, as a matter of Hong Kong law, is a relatively straightforward process. It also provides continuity for the business for the buyer and a clean break for the seller.

What are the key features of an asset sale and purchase?

An asset sale involves the identification and transfer of title to specific assets or categories of assets, and as such is generally more complicated. The target's assets will commonly include land and premises, inventory and work-in-progress, book debts, intellectual property rights, goodwill, insurance, leases, hire purchase and other contracts, and plant and machinery. It will therefore be necessary to transfer each asset or category of assets from the target to the buyer by way of different conveyances, assignments and transfers that, in some instances, will also require consents from third parties not directly involved in the transaction. New permits or authorizations may also be needed to carry on the business. The transfer of assets also raises additional concerns in relation to the employees of the business.

One of the main advantages of an asset acquisition is that the buyer may pick and choose specific assets or liabilities to be purchased or assumed, leaving behind those assets and liabilities that it does not require. The buyer of assets will not generally inherit the target's liabilities, although in this respect the provisions of the Transfer of Businesses (Protection of Creditors) Ordinance must be noted. Under this Ordinance, the buyer of a business, or part of a business, is deemed to be liable for all the debts and obligations arising out of the carrying on of the business by the seller, unless the procedures prescribed by this Ordinance are followed.

Debts and obligations for which a buyer could potentially be liable include sums of money owed by a seller to its creditors; other obligations arising out of contract or tort, such as for breach of contract or product liability; liabilities to employees; or liabilities for unpaid taxes. It is possible to avoid this by publishing certain notices containing specified particulars that have the effect of barring any claim against the buyer that comes later than one month after the notice. If this notice procedure is not followed, proceedings may be issued against the buyer at any time up to one year after the transfer.

The seller's liability to creditors is not affected by the procedure. Note that the effect and requirements of this legislation do not affect indemnities and warranties between the seller and buyer as set out in the acquisition agreement.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

Parties often enter into a letter of intent or term sheet during the initial negotiation process in order to set out the key terms of the proposed acquisition. They will then conduct further due diligence and negotiations, and the letter of intent can then be used to draw up the definitive agreement. Parties can decide whether the letter of intent is intended to be binding or non-binding but whether it legally compels the parties to conclude the deal on those terms, or even at all, will depend on the circumstances. To avoid disputes, the terms of the letter should be clear as to whether it is legally binding or, as is more commonly the case, if only some parts are legally binding (e.g., the governing law, confidentiality and exclusivity provisions).

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: Exclusivity provisions usually form part of a term sheet or letter of intent.
- Break fee: Break fees are not common (but it is common to ask for deposits).
- Confidentiality: Confidentiality provisions usually form part of a term sheet or letter of intent. Alternatively, a confidentiality agreement governing the exchange of confidential information relating to the transaction is typically entered into.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Confidentiality agreements and exclusivity agreements are common separately negotiated agreements. Exclusivity agreements must have adequate consideration, or otherwise be drafted as a deed.

Is there a duty or obligation to negotiate in good faith?

Generally, there is no duty or obligation on the parties to act in good faith in negotiating a contract and they are entitled to act in their own commercial interests in conducting the pre-contractual negotiations. However, this does not mean that there will never be any recourse for a party who has suffered a loss when an agreement fails to be signed and completed. For instance, when the parties have entered into a prior "lock-out" agreement whereby one party undertakes not to negotiate with a third party, provided that such agreement is sufficiently certain as to the time and scope, it may be enforceable and binding on that party and any breach may give rise to contractual remedies (e.g., loss suffered as a result of the party's action to negotiate with a third party in breach of the agreement). A duty to act in good faith may also be implied if it is necessary to give business efficacy to the contract in such "lock-out" agreement depending on the relationship of the parties and how the obligations are worded in the agreement. In addition, even in the absence of any contractual relationship between the parties, a party may sue the other party for negligent or fraudulent misrepresentation depending on the circumstances of the case and the relationship of the parties (e.g., whether there is any relationship of trust and confidence).

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: very common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: debt-free, cash-free is very common. Working capital is fairly common. Locked box is becoming more common, especially in competitive situations. NAV is rarely seen.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely, collars are not common.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually prepared by the target company.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely; not necessarily.

Is an earn-out common?

Frequency/market practice: earn-outs are fairly common where the parties need a mechanism to bridge the valuation gap. They are more common in private equity transactions when sellers continue to manage the target company after closing. They are less common where the seller is completely exiting. Earn-outs are commonly capped.

Is a deposit common?

Frequency/market practice: rarely (Chinese parties are generally more willing to pay a deposit).

Is an escrow common?

Frequency/market practice: fairly common; escrows are used by private equity investors and strategic buyers, and for certain China tax obligations.

Is a break fee common?

Frequency/market practice: rarely. A break fee is more common in competitive bids or if regulatory approval is required, or if a party is willing to pay. (Chinese buyers have done so in the past).

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: uncommon; this is typically only available where there is a long period before execution and completion, or a foreign seller.

Is the MAE general or specific?

Frequency/market practice: both are seen. It is more likely to be specific. It may be general if both parties are from the U.S.

Is the MAE quantified?

Frequency/market practice: rarely; it is more likely to be quantified than general.

Covenants

Is a non-compete common?

Frequency/market practice: very common; but not from private equity sellers.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: waterfall provisions are rarely used.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: very common (in conjunction with non-compete); but not from private equity sellers.

Are non-solicitation provisions (of customers) common?

Frequency/market practice: very common (in conjunction with non-compete); but not from private equity sellers.

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: it is very common, subject to applicable competition law, to give veto rights to the buyer on matters that may have a material effect on the target's business (subject to carve-outs).

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: very common, with reasonable limitations; we generally get this for private deals.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: this is subject to negotiation, on a case by case basis, and it depends on whether there is warranty insurance ("**W&I Insurance**").

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: materiality qualifiers are commonly seen but often not quantified (other than for specific warranties, taking into account the *de minimis* threshold).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: it is often limited to the actual knowledge and due enquiry of a specified list of senior management and people involved in the deal.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: rarely in auction seller's draft; sellers may be willing to consider if there is W&I insurance.

Is disclosure of the data room common?

Frequency/market practice: very common.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common, depending on the parties' bargaining power; repetition at completion is sometimes limited to fundamental warranties if the party has a strong bargaining power.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: rarely.

Is a bring-down certificate at closing common?

Frequency/market practice: bring-down certificates are not very common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: fairly common; true and accurate in all material respects is common but often carve out for fundamental representations which must be absolutely true. If it is a condition to closing, then it may be tied to MAE.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: double materiality is usually avoided.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: the buyer will ask for 100% but it is possible to negotiate down. It ranges from 10%-30% for non-fundamental warranties. It may be higher, depending on the type of buyer and if there is W&I insurance.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: both are seen, subject to negotiation.

What are the common exceptions to the cap?

Frequency/market practice: key warranties are often excepted (e.g., title, capitalization, authority). Often, tax and specific areas of concern are also excepted, sometimes with specific higher caps. Separate caps can be negotiated.

Is a deductible or basket common?

Frequency/market practice: very common.

Is a de minimis common?

Frequency/market practice: very common.

How long does seller liability survive?

Frequency/market practice: a general survival of 18-24 months is common, subject to negotiation. Longer periods may be required. Tax is commonly longer (six to seven years) than general warranties.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: it is common to carve out fraud.

Is warranty insurance common?

Frequency/market practice: it is commonly seen in private equity exits. It is generally becoming more common.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common for actually received.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common for actually received.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: not usually express; required by law.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: this is subject to negotiation.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: Hong Kong is the most common governing law, but other common law jurisdictions, e.g., English law, are sometimes used.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is more common. Hong Kong is predominantly chosen but will typically carve out court or administrative action (e.g., injunction).

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: it is common to share stamp duty payable in Hong Kong, which is 0.2% of the greater of the purchase price and value (usually determined as NAV).

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: rarely.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

Guide to Navigating Global Private M&A

Indonesia

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

In Indonesia, regulatory non-compliance is very common and access to public information is limited. Many Indonesian companies do not maintain adequate records from a legal perspective, or indeed books of account from a financial perspective. Often, information sought in a pre-acquisition review cannot be found readily or simply does not exist. For example, many companies do not maintain share registers, notwithstanding that this is required by law. These would often mean additional costs for rectification and operations post-closing.

In some jurisdictions, asking the seller to clean up before closing is the norm. However, this is not necessarily the case for every situation in Indonesia. Coming up with an appropriate solution requires detailed due diligence and a deep understanding of the local practice and practical risks involved. Seeking protection via a reduction in the purchase price or a holdback of the purchase price may also be advisable.

Legal documentation for an asset acquisition tends to be more complicated than documentation for a share acquisition since the former involves the transfer of different categories of property. Different categories of property will often require different transfer documentation.

Pricing and payment

Mandatory use of rupiah

All domestic transactions should be in Indonesian rupiah, unless those transactions are done in specific business sectors and for specific purposes and/or areas as stipulated by Bank Indonesia. Rupiah is not readily obtained offshore. As such, transactions in rupiah usually require the buyer to have expensive swaps, or alternatively the transaction documents must have an exchange rate mechanism with payment being in foreign currency.

Foreign exchange control

Bank Indonesia has the authority to require information and data in respect of any flow of foreign exchange and has introduced regulations requiring the reporting of transactions over a certain value and limiting the remittance of foreign currency, unless there is an underlying transaction justifying the remittance of the foreign currency abroad.

Bank Indonesia is also authorized to determine (subject to stipulation by the government) the prevailing foreign exchange conversion mechanism.

Signing/closing considerations

Share sale

In light of the current licensing system in Indonesia which focuses more on post audits (known as the online single submission ("**OSS**") system), prior government approval is no longer required for a direct transfer (i.e., onshore acquisition) of shares in an Indonesian company to a foreign buyer. As such, signing and closing can be conducted simultaneously.

Where the Indonesian company is owned by a special purpose vehicle ("**SPV**") outside Indonesia, it is not uncommon for the deal to be transacted as a transfer of shares in the SPV. Apart from Indonesian merger control filing (which may apply if thresholds are met), a transfer of shares in an SPV outside Indonesia is not subject to Indonesian government approval, and simultaneous signing and closing is also possible.

Asset sale

Unless the foreign buyer already has existing entities with the requisite business scope in Indonesia to acquire the assets, there will normally be a gap between signing and closing.

Approvals/registrations

Foreign investment

Acquisitions of shares in an Indonesian company and the acquisition of assets of an Indonesian company are subject to approval by the Ministry of Law and Human Rights ("**MOLHR**"), and administratively registered with certain government authorities.

It is necessary to ensure that the business sectors of the target company are open for foreign investment. Any transfer of shares in an Indonesian company is effective once a share transfer deed is signed by the buyer and the seller. As a post completion action, it is advisable for the target company to check its data in the OSS system, which should have been automatically updated, in order to ensure that the latest shareholding composition has been properly reflected.

In an asset deal, the foreign buyer may need to establish a new entity to acquire the assets. The establishment of an entity could take months to complete, and where operational (technical) licenses are required, e.g., in manufacturing and importation, this could take even longer to complete.

If an existing Indonesian subsidiary of the foreign buyer is used to act as the asset buyer, it is necessary to ensure that its business scope is broad enough to cover the acquired business post-closing. An amendment of the investment plan of the existing Indonesian subsidiary would also need to be conducted.

It may also be necessary for the asset buyer to establish additional branches to operate the business if the acquired business is in a different location than where the subsidiary is registered. The timing for approval or establishment of branches varies depending on the location and whether the target company is regulated. It could range from a few weeks to a few months.

In relation to the acquired assets, it may also be necessary to consider the possible import duties obligation.

Merger control (antitrust/competition approval)

Any share and asset acquisition must be notified to the Business Competition Supervisory Commission ("**Commission**") within 30 working days after the date of the share acquisition (mandatory post-completion notification) if any of the following thresholds are met:

- The combined value of the assets exceeds any of the following thresholds:
  - IDR 2.5 trillion
  - IDR 20 trillion for banks
- The combined value of the sales turnover exceeds IDR 5 trillion.

The thresholds also count assets and sales of affiliates in Indonesia. Please note that on the acquirer's side, assets are calculated on a worldwide basis, not just limited to those located in Indonesia. Asset sales and transactions between affiliates fall outside these merger control rules.

The Commission will review and issue an opinion on the competitive impact of the share acquisition within 90 working days from the date the application is formally accepted.

Other regulatory or government approvals

If public companies are involved in an acquisition or other corporate actions, in addition to the MOLHR requirements, they also need to comply with the regulations issued by the Financial Services Authority ("**OJK**"), the equivalent of the US Securities and Exchange Commission, and the Indonesia Stock Exchange.

Industry consents from the industry regulators may also be required, depending on the nature of the target company's business, e.g., banking, insurance, telecommunications, broadcasting, and mining and land matters. In some industries, a change of control or transfer of assets may simply require notification to the relevant industry regulators rather than there being an obligation to obtain prior consent.

Language

Transaction documents are required to be made in a bilingual format (or any other format the parties choose so long as there is a corresponding version in Indonesian language). The stipulation on the use of English language and/or foreign language, as well as the ability to choose English as the governing language, applies only when there is a foreign party (interpreted as a non-Indonesian entity or a non-Indonesian citizen) involved in the transaction documents.

Employment

Share sale

Employees have the right to choose not to continue their employment with their company in the event of a change of ownership in their company. As such, a discussion with the target company's human resources department on how employees may be dealt with to ensure a smooth transaction is needed. Typically in a transaction, employees will be asked to elect before closing whether they will exercise their rights to be terminated post-closing so that the manpower position is known, or key employees must agree to continue working or a certain percentage of staff at certain levels within the target company must elect not to be terminated.

Asset sale

There is no automatic transfer of employment provisions under Indonesian law, and employees need to be terminated (or negotiated resignation letters obtained) by the selling company, and then the employees rehired by the acquiring company. Normally, where employees consent, employees' accrued entitlements can be taken over by the acquiring company without the need to resort to the Indonesian Relations Court.

Tax

Share sale

Generally, unlisted shares sold by non-resident taxpayers are subject to a 5% final withholding tax (20% of estimated net income of 25% of the sale price). Non-resident taxpayers may be protected from tax by the provisions of any applicable tax treaties subject to fulfilment of certain administrative requirements stipulated under Indonesian local regulations.

Listed shares sold on the exchange by both non-resident and resident taxpayers are subject to a withholding tax of 0.1% of the transaction amount (and an additional 0.5% for founder shares of the share value at prescribed times if the tax for the founder shares has not been previously paid on an initial public offering).

Asset sale

Sellers are required to pay an income tax of 2.5% on the transfer of land and/or buildings, which is a final tax. Generally, buyers are required to pay a 5% duty on the transfer of land and buildings.

Gains, based on the difference between the sale proceeds and book value, on assets sold by an entity are subject to tax at normal rates.

VAT of 10% is also chargeable on assets that are classified as taxable goods sold to an entity/individuals and is incurred by the purchaser provided that the seller is a registered taxable entrepreneur.

If a company has obtained special duty-exemption facilities on certain imports (commonly known as a master list), the transfer of assets within a certain period will result in the initial exemption from duty being revoked and the duty becoming payable, unless approval is obtained and the purchaser itself has a master list covering the assets to be purchased.

Stamp duty

Stamp duty is nominal at IDR 6,000 and is affixed by a duty stamp at the time of signing.

Post-acquisition integration

N/A

Common deal structures

What are the key private M&A deal structures?

Indonesia's legal system is based on the European civil law system. This distinction from many other jurisdictions in the region, together with ongoing regulatory changes, requires careful consideration of the issues that arise in M&A. Most transactions in Indonesia are share deals, because asset deals are quite onerous to complete since there are no transfer of undertaking rules or facilities to transfer across licenses from one legal entity to the other.

Increasingly, sellers are using auction processes with the aim of maximizing price. Not all auction processes are successful, as often the price expectations of buyers and sellers are not aligned. Sometimes, the process is aborted all together. In other instances, the process continues as exclusive negotiations with one bidder. Where an auction process is used, this process is generally governed by one or more process letters issued by the seller or its financial advisers governing the rules of the sale process. Generally, those process letters would provide for two or more rounds of bidding, with generally the first round being a non-binding bid based on limited financial information of the target and the second and subsequent rounds being based on in-depth due diligence by the buyer and with such bids being binding on the buyer.

A key element of Indonesian transactions is that many transactions are not full buy-outs. Typically, a joint venture is created, because of foreign ownership restrictions but also because sometimes the (family) sellers want to retain a stake in the company they built (often a controlling stake). Given that a relatively high number of companies are listed in Indonesia, we also see a relatively large number of deals with a public element.

Mergers are possible, but not very common, in Indonesia. In a merger, by operation of law, all assets and liabilities of the disappearing company are assumed under universal title by the surviving company. As a result of the completion of the merger, the disappearing company is dissolved.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

There are two main types of company that can be established in Indonesia: private companies and public companies. There are substantial differences in the laws and regulations as they apply to public versus private companies. Foreign investors can only invest in a PMA (foreign investment) status company.

What are the different types of limited liability companies?

Limited liability companies are the only type of corporate entity in Indonesia.

Is there a restriction on shareholder numbers?

For a limited liability company, the minimum requirement is that there must be at least two shareholders.

What are the key features of a share sale and purchase?

Under the Company Law, an acquisition is a lawful act executed by a legal entity in the form of a company or other entity, or by an individual, to take over all or a majority of a company's shares, whether existing or newly issued, which may cause a change in the control of the company. The Company Law does not state the meaning of 'control' but it is reasonable to assume that the term refers to the capacity to determine, directly or indirectly, in any way, the management or policies of the company concerned.

Acquisitions instigated by the management of a company are treated differently, and have more complex requirements than an acquisition between an existing shareholder and a proposed new shareholder.

Generally, all that is required to transfer legal title in the shares in an Indonesian private company is for a share transfer deed to be executed by the seller and purchaser (under hand by way of an agreement or in notarial deed form) and then registered in the company's shareholders' register. The transfer is effective on the date of the share transfer deed. However, there are subsequent requirements to notify or make registrations with the MOLHR and other government agencies (including, in some circumstances, changes in licensing).

What are the key features of an asset sale and purchase?

When a business is being transferred by way of an asset purchase, each individual asset must be transferred in accordance with the formalities applicable to that type of asset. For some assets, this will simply be a case of delivering the asset to the purchaser, but in other cases, the formalities are more prescriptive, as is the case in real property or intellectual property transfers. It is therefore necessary to include a provision, either in the purchase agreement governing the purchase of the business and its assets or in separate agreements, for the relevant formalities to be complied with.

In conducting an asset purchase in Indonesia, acquirers need to be aware of:

- the multitude of government agencies that may be involved in effecting the transfer of registrable assets;
- procedures for acquiring good title to land; and
- the often time-consuming efforts needed to:
  - obtain consents and approvals (including those from banks, third parties and government agencies);
  - establish the new investment company as the purchaser;
  - obtain all general and industry-specific licenses for the business being acquired;
  - apply for expatriate work plans and permits; and
  - transfer over employees and deal with statutory benefits that they may be entitled to on the transfer.

While these matters are not insurmountable, they do make closing an asset acquisition much more difficult and time-consuming than a transaction involving shares. In many respects, the business in an asset sale needs to either cease operating until all licenses are obtained or otherwise operate without licenses in its name (this is a consequence of licenses not being transferable in Indonesia).

In contrast, share acquisitions generally require far fewer consents and approvals and are less problematic.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

This really depends on the parties themselves, but we wouldn't say it is customary to prepare a letter of intent or term sheet. Most often, parties move to full documentation directly. Where such letter of intent or term sheet is prepared, it depends on the terms of those agreements whether and to what extent they are binding on the parties. Generally, we see parties electing to award a binding effect to provisions on timing, governing law and costs, but not to the other (more substantive) provisions. Indonesian law does not specifically regulate whether a letter of intent or term sheet is binding on both parties, but there have been Supreme Court cases providing that term sheets must be interpreted in good faith even though they were expressed to be non-binding.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: Exclusivity provisions are commonly included in letters of intent or term sheets.
- Break fee: Break fees are rarely seen, certainly not in a term sheet.
- Confidentiality: It is more common to draft a confidentiality agreement as a separate document.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

It is common to negotiate a separate confidentiality agreement as well as a separate exclusivity agreement. Confidentiality agreements are often dealt with separately as they are quite detailed and not easily integrated into a term sheet. Exclusivity provisions also feature in letters of intent or term sheets.

Is there a duty or obligation to negotiate in good faith?

In general there is no requirement under the Indonesian Civil Code for an agreement to be made in writing, but an unwritten agreement (verbal) does make it difficult to prove whether a breach has occurred (as Indonesian law generally requires at least two valid pieces of evidence to be presented to support a claim).

Further, there is no statutory definition of "good faith." However, the accepted legal doctrine and practice in Indonesia is to interpret "good faith" under Article 1338 of the Indonesian Civil Code as meaning "reasonableness (*kepantasan; redelijkheid*) and equity (*keadilan/kepatutan; billijkheid*)."

Article 1338 of the Indonesian Civil Code requires agreements to be performed in good faith. Further, Article 1339 of the Indonesian Civil Code stipulates that agreements bind parties not only to what is expressly stipulated, but also that which, pursuant to the nature of the agreement, shall be imposed by propriety, customs or the law. These provisions of the Indonesian Civil Code give a court or arbitral tribunal reasonable discretion to allow deviations from the express wording of an agreement (including agreements that have not been made in writing).

The Civil Code provisions do not specifically address pre-contractual good faith and there is no consensus on whether Article 1338 can be read to also require parties to act in good faith prior to concluding an agreement. As there is no clear provision on pre-contractual good faith under the Indonesian Civil Code, given Indonesia is a civil law state, it is up to the relevant court or arbitral tribunal to determine the exact scope of the obligation in the circumstances of each case. In general, acting in good faith refers to the observance of reasonable commercial standards of fair dealing or acting in accordance with reasonableness and equity. Therefore, it can be said that, based on the principle of good faith under Articles 1338 and 1339 of the Indonesian Civil Code, both parties to a contract (or if interpreted broadly, parties conducting negotiations) are required to behave in their relationship according to what is reasonable and equitable.

Under Indonesian law, failing to perform a contractual obligation may give rise to several remedies and the aggrieved party may, in general, claim the following:

- specific performance (if such performance is still possible) and damages;
- damages instead of specific performance;
- setting aside the contract (invoking the consequences of discharge by breach); or
- setting aside of the contract and damages.

Only damages that are reasonably foreseeable and that are immediate and a direct result of the breach are recoverable.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: purchase price adjustments are fairly common, especially where sophisticated parties are involved and the size of the deal is substantial.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: adjustments are generally based on net debt or working capital adjustments. However, in some transactions involving Indonesian conglomerates, we have seen that (i) purchasers request that sellers use the debt-free and cash-free mechanism; or (ii) parties agree a locked-box mechanism.

At the same time, we see a locked box purchase price adjustment mechanism gaining traction with sellers.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely; this is generally not acceptable.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is a point of negotiation, given the advantage of being able to instruct the auditor who will prepare the closing balance sheet. We see both options being agreed, depending on the negotiating position of the parties.

Is the balance sheet audited (where applicable)?

Frequency/market practice: fairly common; in larger transactions, we would typically see this statement being reviewed by an auditor.

Is an earn-out common?

Frequency/market practice: rarely/not at all.

Is a deposit common?

Frequency/market practice: rarely/not at all.

Is an escrow common?

Frequency/market practice: rarely/not at all.

Is a break fee common?

Frequency/market practice: rarely/not at all.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common; this is a point of substantial negotiation. This condition is becoming more and more acceptable, given the relatively long period between signing and closing in Indonesia.

Is the MAE general or specific?

Frequency/market practice: where an MAE is accepted, it is generally a specific MAE.

In unpredicted situations (e.g., during the COVID-19 outbreak in 2020) we see that parties are starting to request a specific MAE clause related to force majeure.

Is the MAE quantified?

Frequency/market practice: rarely; this depends on the parties. However, there is a trend towards parties agreeing to a quantification of the MAE trigger.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: waterfall provisions, etc. are rarely used.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: common (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: common (in conjunction with a non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; this depends on the sophistication of the parties. Sometimes, parties limit the permitted reasons for the right to access so that it is not broad.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: rarely; it is uncommon to update warranty disclosure. Notification of breach is common — usually by default (but has been resisted in deals recently by sophisticated offshore sellers).

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen and often not quantified (other than specific warranties, e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are common. These are generally limited to a group of persons. Arguments still prevail over actual knowledge or knowledge after due enquiry (prior to signing the agreement).

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: this depends.

Is disclosure of the data room common?

Frequency/market practice: very common; other than against fundamental warranties.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common; repetition at completion is common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: this issue is always a point of discussion, whether it is agreed depends on the negotiation position of the parties involved.

Is a bring-down certificate at closing common?

Frequency/market practice: bring-down certificates are very common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate in all material respects.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely; double materiality is usually avoided.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: the buyer will ask for 100%. If an offshore firm (or an Indonesian firm affiliated with an offshore firm) is advising, usually a lesser percentage is used for business warranties, e.g., 20-50%.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: generally, the overall (purchase price) cap applies to all claims.

What are the common exceptions to the cap?

Frequency/market practice: fundamental warranties are often excepted (e.g., title, capitalization, authority). Often, tax and specific areas of concern are also excepted, sometimes with specific higher caps. Separate caps can be negotiated.

Is a deductible or basket common?

Frequency/market practice: fairly common; a basket is common.

Is a de *minimis* common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: fairly common; a general survival of 18-24 months is common. Fundamental warranties and tax warranties are commonly longer than general warranties (five years).

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: it is common to carve out fraud.

Is warranty insurance common?

Frequency/market practice: rarely; this is not used very often, but it is making its market entry in Indonesia.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: rarely.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: fairly common; it is common to request, but is not required by law.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common; if Indonesian law is used, usually only direct damages (foreseen) are recoverable.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: it is fairly common for the warranties (but not indemnities) to be qualified by the buyer's knowledge.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: governing law varies, depending on the parties. Singapore law can be used and if UK firms are involved they will try to argue for English law.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is more common; usually the SIAC in Singapore. Some Indonesian parties refuse offshore arbitration and some insist on Indonesian arbitration, commonly known as BANI (Indonesian National Arbitration Board).

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: stamp duty is only IDR 6,000 per document, and the parties can agree who pays (whether orally or in the transaction agreements).

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: it is fairly common to have a tax indemnity, usually included in the purchase agreement. It is usually in short form.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

The following issues are not the only ones to consider when entering into a private M&A transaction but are representative of the complexity of some of the issues commonly addressed.

Baker McKenzie.

Guide to Navigating Global Private M&A

Italy

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

Typical legal due diligence issues in Italy include material contracts, financing agreements, corporate documentations, compliance, real estate, employment, health & safety and pension, IP, IT and personal data processing, regulatory/public law matters, environmental law matters and litigation. Competition law analysis has also received increased attention in due diligence exercises.

It is essential to precisely determine the target company's business to ensure an efficient legal due diligence review.

The legal due diligence is typically limited to a review of documents uploaded in a virtual data room, sometimes supplemented by management interviews. Usually, the potential buyer may submit questions to the seller and/or its consultants, or to the target's management to clarify specific issues identified during due diligence. For larger auction sales, it is common for a seller to provide a vendor with a due diligence report as part of the information granted to bidders.

Independent appraisal

In a typical private M&A transaction (share deal or asset deal), there is no statutory requirement to obtain independent appraisals. For certain other types of corporate transactions (e.g., capital contributions in kind), independent appraisals are mandatory.

Payment

There are generally no restrictions on pricing or payment of the purchase price from a legal perspective. Most commonly, the purchase price is paid in euro. In any event, a conversion in Euro of the price as of the date of transfer is required (i) for the purpose of payment of the tax applicable to the transfer of shares (Tobin Tax) in the case of SpA (joint stock company — *Società per Azioni*) and also (ii) in the case of transfer of quotas by means of a notarial deed of transfer for Srl (limited liability company — *Società a Responsabilità Limitata*).

Signing/closing

Acquisition methods

Under Italian law, a concentration of two or more businesses into one company may be achieved mainly by purchase of shares or purchase of assets. Generally speaking, Italian sellers tend to prefer share transactions, because usually the share purchases can be finalized more quickly with the completion of certain corporate formalities without the need for prior consultation with trade unions. Moreover, Italian sellers may prefer share deals since; in asset deals they usually remain, in principle, jointly and severally liable with buyers for liabilities existing at the closing date.

Share sale

In an acquisition of shares, the buyer steps into the position of the seller in respect of the acquired company. The acquired company will be transferred subject to all existing liabilities, although these can be addressed by means of warranties and indemnities (between the parties).

The shares in an SpA (joint stock company — Società per Azioni) and participation in an Srl (limited liability company — Società a Responsabilità Limitata) are freely transferable, unless otherwise provided for by the bylaws. An SpA's bylaws may prohibit the transfer of the shares absolutely for a maximum period of five years from the company's incorporation or from the date of special shareholder resolution which resolved to include this restriction in the bylaws. Restrictions may be also included in the shareholders' agreements. Restrictions in the bylaws are binding on, and enforceable against, the shareholders and the company, as well as third parties. Restrictions in shareholders' agreements are only binding on, and enforceable against, the shareholders. The bylaws may subject the transfer of the shares in the SpA to the discretionary approval of the company's corporate bodies or the shareholders, and if approval is not granted then either:

- the company or the other shareholders must purchase the shares; or
- the selling shareholder can exercise its right of withdrawal from the company.

If the bylaws of an Srl provide for the absolute non-transferability of quota, or require that the transfer be subject to the prior approval of the company's corporate bodies, quotaholders or third parties, either without conditions or limitations, or with conditions and/or limitations which, in practical terms, do not allow the transfer, then the quotaholder may withdraw from the company. The bylaws of an Srl may provide for a term of up to two years from the incorporation of the company or subscription of the quota, before which the right of withdrawal may not be exercised.

The bylaws of SpA and Srl companies may also provide for pre-emption or first refusal rights, requiring a shareholder who intends to transfer its shares to first offer them pro rata to the other shareholders.

Other examples of restrictions on share transfers in the company bylaws may include, subject to certain limitations, lock up provisions, as well as tag-along and drag-along rights.

Signing: At signing, seller(s) and buyer(s) usually execute the acquisition agreement with its annexes. There are no specific formalities under Italian law for the execution of relevant preliminary share (or quota) sale and purchase agreements — either for an SpA or for an Srl.

Closing: For an SpA, the participation is usually transferred by (i) endorsement of the share certificate(s) in favor of the buyer, to be executed before a Notary Public and subsequently recorded in the shareholder's ledger ("*libro soci*") with all of the buyer's details; as new shareholder of the SpA (this is the most common way) OR (ii) by executing a notarial deed of transfer from seller to buyer; then the buyer's details are to be recorded in the share certificate(s) (if existing) and in the shareholder's ledger ("*libro soci*") (this is usually implemented when no shares certificate(s) exist, i.e. in case of "dematerialized shares").

For an Srl, the sale of quota must be perfected by a final quota transfer agreement signed before a notary public — either as a public deed or as a private agreement with notarized signatures — and registered by the notary public with the local Registry of Enterprises within 30 days of execution.

In most cases, signing and closing do not occur simultaneously, with the parties usually agreeing to conditions precedent to closing (including, if applicable, the obtainment of clearance from competition authorities that may be required to complete the transaction).

Asset sale

The acquisition of the assets of a target Italian business may be achieved through a sale or contribution of the target's business as a going concern or of a branch of the business. A purchase of assets gives the buyer a higher degree of isolation from the overall liabilities of the seller. On the transfer of part of a business as a 'going concern', it is necessary to identify the extent of the business, so the list of assets and liabilities is appropriate to help identify the business being transferred. Lack of identification of certain assets (registered assets, contracts) might adversely affect their assignment. Although the buyer and the seller remain jointly liable vis-à-vis the seller's creditors for the seller's liabilities (therefore, the relevant unsatisfied creditors of the seller could later on also raise their claims against the purchaser of the business), this is limited to liabilities specifically reflected in the seller's accounting books (which the buyer should thoroughly inspect before entering into the sale agreement). As between the buyer and the seller, the buyer may further limit its liabilities through the sale transaction documentation.

Specific rules are provided with respect to labor and tax liabilities. In more detail, the purchaser will be liable, jointly with the seller:

- vis-à-vis the employees for the payment of severance ("**TFR**") and any other payments or obligations connected to the employment relationships that were accrued at the time of the transfer; and
- for the seller's tax liabilities (including unpaid taxes and penalties due for any non-compliance with tax laws) of the transferred business related to the year in which the closing occurred and to the 2 prior years (and for any tax assessments by the tax authority in the same period), regardless of whether they were reflected or not in the seller's accounting book.

NOTE: before completion of the transfer, the purchaser can apply for a certificate issued by the tax authorities relating to the seller -stating whether there are any outstanding liabilities at the transfer date. If the certificate shows there are no such liabilities or the authority does not issue a certificate within 40 days, the purchaser is exempted from the joint liability for pre-transfer taxes. Otherwise, if the issued certificate shows pre-transfer taxes, the purchaser's liability is limited to those indicated in the same certificate.

Closing: Each asset must be transferred according to the transfer formalities that apply to that type of asset. The transfer of a business as a going concern must be perfected by a business transfer agreement signed before a notary public — either as a public deed or as a private agreement with notarized signatures — and then filed with the local Registry of Enterprises and any other relevant local register, depending on the nature of the assets transferred. For example, if real estate assets were transferred, the change of ownership of that real estate must also be recorded in the local Real Estate/Land Registry.

Approvals/registrations

Investments in strategic sectors

Under Law No. 56 of 11 May 2012 (as subsequently amended), the Italian government has "Special Powers" which give the Italian government the ability to veto or impose conditions on a transaction involving a change of control (or the acquisition of certain percentages of the corporate capital) over companies that hold strategic assets in the following sectors: defense and homeland security (which includes 5G technology networks and services), energy, transportation and telecommunications. Pursuant to Law Decree no. 23/2020, the Special Powers are now extended also to the purchase of participations in companies which hold assets and contractual relationships in the following sectors ("**Listed Sectors**"):

- Critical infrastructure- whether physical or virtual – including energy, transportation, water, health, communications, media, data processing or storage, aerospace infrastructures, defence, electoral or financial infrastructures (including banking, finance and insurance) and sensitive facilities as well as the investments in land and real estate that are crucial for the use of the above-mentioned infrastructures;
- Critical technologies and dual use items, including artificial intelligence, robotics, semiconductors, cybersecurity, aerospace, defense, energy storage, quantum and nuclear technologies as well as nanotechnologies and biotechnologies;
- Security in the supply of critical inputs, including energy and raw materials as well as food security;
- Access to sensitive information including personal data or the ability to control such information;
- Freedom and pluralism of the media;
- Banking, finance as well as insurance sectors.

Transactions involving assets in these sectors must be reported to the Office of the Prime Minister for prior authorization. Once notified, the Government has 45 days to clear, veto or impose undertakings on the transaction. The above term is reduced to 30 days in the case of notifications concerning 5G ECNS.

Such terms may be (i) suspended once if the Government requests additional information from the relevant company/purchaser (with such information having to be rendered in 10 days); (ii) suspended once if the Government requests additional information from a third party (with such information having to be rendered in 20 days); and (iii) discontinued if the notification is incomplete so that the term starts again once the outstanding information is provided to the Government. At the expiry of the terms, the transaction at stake is deemed approved.

Failure to notify triggers an administrative penalty of a maximum of twice the value of the transaction and, in any event, no less than 1% of the aggregate turnover of the companies involved. In addition, if a transaction is implemented in breach of the veto or the conditions imposed, the transaction is void and the Italian government may require the parties to reinstate the situation as it existed before the transaction, at their expense.

Merger control

Merger control in Italy is governed by the Law of 10 October 1990, no. 287, and the competent authority to review mergers is the Autorità Garante della Concorrenza e del Mercato (Italian Competition Authority — ICA).

According to the Law of 10 October 1990, no. 287, a concentration is deemed to arise when there is a change of control on a lasting basis. This is the case when: (i) two or more undertakings merge; (ii) one or more undertakings acquire the direct or indirect control of the whole or parts of one or more undertakings, whether through the acquisition of shares or assets, or by contract or by any other means; and (iii) two or more undertakings create a full-function joint venture by setting up a new company.

A transaction, amounting to a concentration and not having an EU dimension, must be notified by the party (or parties) acquiring control to the ICA if, in the last business year preceding the concentration:

1. the combined domestic turnover realized by of all the concerned parties exceeded EUR 504 million; and
2. the domestic turnover realized by each of at least two of the concerned parties exceeded EUR 31 million.

Turnover consists of the total amount of sales for the provision of goods/services realized in the last financial year and is usually allocated geographically to the place where the customer is. Special rules apply to calculate turnover in the banking and insurance sector. Turnover thresholds are subject to yearly review. A concentration must be notified to the ICA before it is implemented. However, the Italian merger control regime is not suspensory, meaning that once notification is made, there is no need for the parties to wait for the ICA to clear the transaction, provided that the parties are prepared to accept the risk that the ICA may open an investigation and decide that the transaction must be unwound. Failure to notify is subject to an administrative fine of up to 1% of the turnover realized in the year prior to that in which the failure to notify is ascertained by the ICA.

As for the timing, Phase I (for transactions not raising any competition concern) lasts 30 calendar days from the date the notification is received, whereas Phase II (for transactions which need an in-depth review) lasts 45 calendar days from the date of the ICA's decision to initiate the investigation (with the possibility for the ICA to extend this deadline up to 30 days if the parties do not provide the information requested by the ICA).

On the merits, a concentration may be prohibited if it determines the creation or strengthening of a dominant position on the market such as to eliminate or restrict competition appreciably and on a lasting basis.

Depending on the impact that the concentration may have on the market, and if the competition issues raised by the concentration can be cured, the ICA can clear the transaction subject to commitments.

Other regulatory or government approvals

Other regulatory or government approvals or filings must be evaluated on a case-by-case basis, depending on the relevant industry, deal structure and actual circumstances (e.g., assignment of public contracts in an extraordinary transaction, transfer of operational permits, renewal of anti-mafia affidavit).

Employment

Acquisition of shares

An acquisition of shares is not considered a transfer of an undertaking or of a business for employment law purposes. Therefore, it will not involve the transfer of employees but simply a change in the ownership of the employer. As such, the buyer inherits all the employees' rights, duties and liabilities by virtue of being the new owner of the target company. However, some National Labor Collective Agreements (NLCAs) provide that directors or managers are allowed to resign and receive certain payments in the case of a change of control of an employer. In share acquisitions, there is no requirement to inform or consult trade unions/works councils, unless the NLCA provides otherwise.

Acquisition of assets

The transfer of an undertaking or of (part of) a business is regulated by the Italian Civil Code that implemented the EU Acquired Rights Directive. In an acquisition of assets, the TUPE principle of continuing the employment relationship and safeguarding employees' acquired rights applies. Mergers, demergers, usufruct or leases of businesses also fall within the scope of the Italian Civil Code and are treated in the same way as an acquisition of assets. When there is a transfer of an undertaking or of (part of) a business, the employment agreements with the transferor automatically continue with the transferee. Transferred employees maintain their seniority rights together with their existing terms and conditions of employment, save for any change in the NLCA. The transferee is jointly liable with the transferor for all the entitlements and claims of the employees at the time of the transfer. However, the employee may release the transferee from its obligations by signing a release or a waiver before a competent labor office or before unions.

Transfer of a business per se is not a valid cause for dismissal. Employees whose terms and conditions of employment are materially affected during the three months following the transfer may resign for just cause, claiming payment of an indemnity in lieu of notice and, possibly, also damages.

By law, a specific consultation procedure with the unions and works councils (if any) has to be carried out before the transfer, if the transferor employs more than 15 employees. By means of a notice which must include certain specific information, the unions must be notified of the intention to transfer at least 25 days before the transferor and transferee execute a binding agreement. Within seven days of receipt of a notice of request of the unions and/or works council, the transferor and transferee must start and take part in negotiations. The negotiations are considered concluded (and the planned transaction can take place) if no agreement is reached within 10 days from the start of the consultation procedure.

Failure to comply with the consultation procedure may constitute anti-union behavior, to which the unions may object by filing a petition in court.

Tax

Acquisition of shares

Capital gains triggered by a share deal transaction will be subject to CIT at the standard rate of 24%.

However, the capital gain could benefit from an exemption from CIT up to 95% of their amount, provided that the following conditions for benefiting from the PEX regime are met:

- The participation must be held uninterruptedly from the beginning of the 12 months preceding the transfer.
- The participation must have been accounted for as a long-term investment (fixed asset) in the first balance sheet of the holding period.
- The target company must be a resident of a state or territory other than those having a privileged tax regime, unless a ruling has been obtained that the holding of the participation does not result in localizing the income in a "blacklist" country.
- The target company must carry out a real business activity.

The transfer of title to shares by way of endorsement of the share certificates is subject to the Tobin tax. The Tobin tax is levied on any transfer of title to shares in a SpA as well as in joint-stock companies with registered offices in Italy, even if the transaction is executed between individuals/entities that are not resident in Italy. Buyers of shares pay the tax on the sum paid for shares. For shares of listed companies, the Tobin tax applies at a tax rate of 0.1% (with an exemption for companies whose average market capitalization on November of the year prior to the year when the transaction was entered into is lower than EUR 500 million); for non-listed companies, the rate is 0.2%. The Tobin Tax applies to the value of the transaction (the value of the transaction is deemed to be the net balance of the transactions executed and settled on the same financial instruments by the same subject on the same day or at the paid price). The quota transfer agreement (in a Srl) is subject to a fixed registration tax equal to EUR 200. However, if a third party (e.g., the parent company of a party) is acting as guarantor to the agreement, the guarantees are subject to tax at 0.5%, applicable to the total guaranteed amount. The seller and the buyer are jointly liable for the payment of the registration tax.

Acquisition of assets

The capital gain deriving from an asset deal operation is subject to CIT at the standard rate of 24%. The tax basis is equal to the difference between the sale price and the non-amortized cost.

The transfer of a business as a going concern is subject to a 3% registration tax levied on the fair market value of the business transferred, i.e., the value of the assets, including goodwill at its fair market value, less the amount of any liabilities. If there is real property among the assets transferred, the net value of the real property is taxed at 9% (15% for farmland; and EUR 50 each for mortgage and cadastral taxes (total EUR 100) apply as well to both transfers of real property and of farmland). If there are finance leasing agreements related to commercial real property, the transfer of these agreements within the context of the transfer of a business as a going concern is taxed at 4%. Registration tax is calculated as the sum of the following:

- the portion of the purchase price referred to the leasing agreements; plus
- the principal amount incorporated in the instalments still to be paid; plus
- the leasing redemption price.

If there are receivables among the assets transferred, these will be subject to a 0.5% registration tax rate, as opposed to the ordinary 3% rate, if the value/consideration paid in lieu of receivables is clearly identified in the agreement. The seller and the buyer are jointly liable for the payment of registration tax applicable to transfer of a business as a going concern. Cars and other registered movable goods are subject to minor fixed registration taxes.

Others

Merger: Mergers are subject to a fixed registration tax equal to EUR 200. Generally, mergers are tax neutral in Italy.

Value Added Tax (VAT): No VAT is due with respect to either an acquisition of shares or an acquisition of a business as a going concern.

Post-acquisition integration

The process of post-closing integration usually involves certain mandatory filings/procedures to be finalized in accordance with specific deadlines, such as:

- in a share sale: it is common that the group of companies to which the Italian target belongs changes and, therefore, it will be necessary to notify the public authorities of the new controlling company that exercises direction and coordination prerogatives; it is also mandatory to notify the Register of the Enterprises if, further to the share sale, the target company is owned by a sole stockholder; or
- in an asset sale: the notification to social security authority of the transfer of employees, as well as the notification of the transfer of a business unit with the Register of the Enterprises.

It is also common that new corporate bodies are appointed (e.g., new members of management bodies and controlling bodies), and also new delegation of operative powers are granted.

Operational integration/transitional services arrangements are common when the business may not be able to function on a standalone basis immediately after the acquisition.

Common deal structures

What are the key private M&A deal structures?

Under Italian law, a concentration of two or more businesses into one company may be achieved mainly by purchase of shares or purchase of assets. Generally speaking, Italian sellers tend to prefer share transactions, because usually the share purchases can be finalized more quickly with the completion of certain corporate formalities without the need for prior consultation with trade unions. Moreover, Italian sellers may prefer share deals since in asset deals they usually remain jointly and severally liable with buyers for liabilities existing at the closing date.

Mergers and consolidations are also common practice in Italy. A merger occurs where the assets and liabilities of one or more companies, including its or their corporate name and identity become part of the assets and liabilities of another. The latter will be treated as the successor of the former. At the end of the process, only the surviving company will remain. A consolidation is a variant of a merger and occurs when two or more companies pool their assets and liabilities by forming a new company. At the end of the process, only the new company will be in existence and will be treated as the successor of the consolidated companies.

Auction processes are often seen in Italy, particularly for major deals and/or when seller(s) is/are private equity player(s). The tendency is more and more towards managing auctions through bid process letters having a binding nature rather than through indicative non-binding letters. Usually in the first round of the process, bidders are invited to submit their offers based on limited and preliminary information received by seller(s) (usually by means of a vendor due diligence report). Then, the selected bidders who are admitted to the second round are allowed to conduct full due diligence investigations, and are requested to submit their binding offers by providing comments on a draft acquisition agreement commonly prepared by the seller(s).

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

In Italy there are two forms of corporation assuring limited liability to all the shareholders, namely the joint stock company (Società per Azioni — SpA) and the limited liability company (Società a responsabilità limitata — Srl).

What are the different types of limited liability companies?

Società a responsabilità limitata are normally used for closely held companies with limited equity. The minimum capital is EUR 10,000 divided into 'quota' (rather than shares) which are not represented by certificates. Each shareholder is granted just one quota having a nominal value corresponding to the portion of the corporate capital subscribed by it. The governance of this type of company is more flexible than that of SpAs and is well suited not only for smaller scale operations, but also as a fully owned subsidiary vehicle in Italy of a multinational parent corporation or, in certain circumstances, as a joint venture company.

Srls may also be incorporated with a capital lower than EUR 10,000 (equal to at least EUR 1), but in such cases the Srls must allocate at least 20% of the yearly profits to the mandatory reserve until the aggregate value of the corporate capital and of the mandatory reserve jointly hit the threshold of EUR 10,000.

In joint stock companies (*Società per Azioni*) — SpA) the minimum required corporate capital at incorporation is EUR 50,000. The capital is divided into shares, and the liability of the shareholders is limited by shares. Shares can be issued as certificates (and recorded in the shareholders' ledger "*libro soci*") or they can be dematerialized - therefore no certificate(s) exist(s) - and therefore they can be issued in book-entry form. Each Shareholder is granted a number of shares which is proportional to the portion of the corporate capital subscribed, for a value which cannot be higher than the value of the contribution made. The aggregate value of the contributions cannot be lower than the total amount of the corporate capital. Shareholders of an SpA usually have equal rights (Civil Code, art. 2348). However, an S.p.A. may also issue, besides ordinary shares, special categories of shares.

Is there a restriction on shareholder numbers?

There are no restrictions imposed by law. The minimum/maximum number of shareholders is generally regulated in the relevant company's bylaws.

What are the key features of a share sale and purchase?

In an acquisition of shares, the purchaser steps into the position of the seller in respect of the acquired company. The acquired company will be transferred subject to all existing liabilities, although these can be addressed by means of warranties and indemnities (between the parties).

The shares in an SpA and participation in an Srl are freely transferable, unless otherwise provided for by the company's articles of association/bylaws. The bylaws of an SpA may provide for absolute non-transferability of the shares for a maximum period of five years from the date of incorporation of the company or from the date of the special shareholders' meeting which resolved to include such restriction in the bylaws of the company. Restrictions may be also included in the shareholders' agreements. Restrictions in the bylaws are binding on, and enforceable against, the shareholders and the company as well as third parties. Restrictions in shareholders' agreements are only binding on, and enforceable against, the shareholders. The bylaws may subject the transfer of the shares in the SpA to the discretionary approval of the company's corporate bodies or the shareholders. If they state that (and if such approval is not granted) then either:

- the company or the other shareholders must purchase the shares; or
- the selling shareholder can exercise its right of withdrawal from the company.

If the bylaws of an Srl provide for the absolute non-transferability of the quota, or require that the transfer be subject to the prior approval of the company's corporate bodies, quotaholders or third parties, without conditions or limitations, or else provide for conditions and/or limitations which, in practical terms, do not allow the transfer, then the quotaholder may exercise the right of withdrawal from the company. The bylaws of an Srl may provide for a term, not exceeding two years from the incorporation of the company or subscription of the quota, before which the right of withdrawal may not be exercised.

The bylaws of SpA and Srl companies may also provide for pre-emption or first refusal rights, whereby any shareholder who intends to transfer, for any reason, its shares, shall first offer them pro rata to the other shareholders.

Other examples of restrictions on share transfers in the company bylaws may include, subject to certain limitations, lock up provisions as well as tag-along and drag-along rights.

What are the key features of an asset sale and purchase?

The acquisition of the assets of a target Italian business may be achieved through a sale or contribution of the target's business as a 'going concern' or of a branch thereof. A purchase of assets provides a higher degree of isolation of the purchaser from the overall liabilities of the seller and permits the selection of the specific assets to be transferred. On the transfer of part of a business as a 'going concern', it is necessary to identify the extent of the business, so that the list of assets and liabilities is appropriate to help identify the business being transferred. Lack of identification of certain assets (registered assets, contracts) might adversely affect their assignment. Although the purchaser and the seller remain jointly liable vis -à-vis the seller's creditors for the seller's liabilities (therefore, the relevant unsatisfied creditors of the seller could later on also raise their claims against the purchaser of the business), this is limited to liabilities specifically reflected in the seller's accounting books (which the purchaser should thoroughly inspect prior to entering into the sale agreement). Specific rules are provided with respect to labor and tax liabilities. In more detail, the purchaser will be liable, jointly with the seller:

- vis-à-vis the employees for the payment of severance (TFR) and any other payments or obligations connected to the employment relationships that are accrued at the time of the transfer; and
- for the seller's tax liabilities (including unpaid taxes and penalties due for any non-compliance with tax laws) of the transferred business related to the year in which the closing occurred and to the 2 prior years (and for any tax assessments by the tax authority in the same period), regardless of whether they were reflected or not in the seller's accounting book.

NOTE: before completion of the transfer, the purchaser can apply for a certificate issued by the tax authorities relating to the Seller - stating whether there are any outstanding liabilities at the transfer date. If the certificate shows there are no such liabilities or the authority does not issue a certificate within 40 days, the purchaser is exempted from the joint liability for pre-transfer taxes. Otherwise, if the issued certificate shows pre-transfer taxes, the purchaser's liability is limited to those indicated in the same certificate.

As regards the purchaser and the seller, the former may further limit its liabilities through ad-hoc provisions to be inserted into the sale transaction documentation.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

It is customary to prepare letters of intent. They are generally non-binding, as their main purpose is to register and summarize the status of the negotiations. Typically letters of intent provide for the structure of the transaction and an exclusivity period. Provisions relating to confidentiality, standstill clause, non-solicitation, exclusivity, costs and governing law and jurisdiction are usually binding provisions, while no commitment is normally assumed by the parties in relation to the finalization of the transaction.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: It is common practice to include an exclusivity provision, which is generally a period of three to four weeks, pursuant to which the buyer may be granted the right to negotiate exclusively for a period of time with the seller, which - in turn - will be prevented from engaging in discussions or sharing information on the target company with any third party. Exclusivity clauses are usually binding, despite the fact that the general provisions of a term sheet are usually non-binding. In case of breach of exclusivity, the potential buyer can seek compensation for damages from the seller as well as from a third party buyer, if it is ascertained that the latter was aware of the exclusivity undertakings between the parties.
- Break fee: It is not common to include break fees in Italian agreements. This is mainly because Italian law already provides for a specific pre-contractual liability in case negotiations are interrupted by a party who is not acting in good faith. In this case, the costs/damages incurred by the other party would be recoverable even in the absence of any specific contractual break fee or penalty.
- Confidentiality: Yes, it is common practice to include binding provisions on confidentiality, although it is usual to also enter into separate confidentiality agreements or non-disclosure agreements ("**NDAs**") to set out in detail the terms of the relevant obligations of the parties. Such agreements generally provide for the obligations of the parties involved to treat as confidential the information exchanged during the negotiations, including the existence of the negotiations itself. Specific exclusions in order to limit the confidentiality obligations may be included. The confidentiality agreements may also contain non-solicitation clauses aimed at limiting the access of the buyer to the employees, suppliers and customers of the target company.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Confidentiality obligations are often separately negotiated in agreements rather than provisions in letters of intent/term sheets (for further details see the paragraph above). This is sometimes also the case for exclusivity. Regarding confidentiality, this is usually addressed by the parties before entering into any negotiation. Break fees are generally not used in Italy.

Is there a duty or obligation to negotiate in good faith?

The Italian Civil Code mandates all parties to act in good faith during the negotiation and drafting of the acquisition agreements. Failure to do so will expose the defaulting party to pre-contractual liability (including, but not limited to, making untrue statements, omitting to disclose essential information, failing unjustifiably to complete the transaction after inducing a reasonable reliance through negotiations with the buyer that completion would haveoccurred).

In particular, where fraudulent misrepresentations by the seller induce the buyer to enter into an acquisition agreement, which the latter would not have finalized had it been aware of the actual circumstances behind the transaction, the buyer may decide not to conclude the agreement. However, if the buyer would have still executed the agreement but under different terms and conditions, the same agreement is valid but the seller is liable for the damages possibly suffered by the buyer.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: very common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: very common; NAV is very common in asset deals. In share deals, debt-free; cash-free; and working capital are very common.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: the buyer usually has the responsibility of ensuring the target company prepares this.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely.

Is an earn-out common?

Frequency/market practice: earn-outs are fairly common in private equity transactions when the seller keeps managing the target company after closing. They are rare where the seller is completely exiting, though market practice has begun to see a few cases of earn-out in such scenarios.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: fairly common.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common, although enforceability may be problematic especially in the case of general clauses.

Is the MAE general or specific?

Frequency/market practice: usually general, though market practice is beginning to see specific MAE clauses as well due to possible enforceability issues.

Is the MAE quantified?

Frequency/market practice: rarely.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: fairly common; waterfall provisions are common.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common (in conjunction with non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common (in conjunction with non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: fairly common.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; depends on the sophistication of the parties. Usually, private equity sellers resist and limit for transitional purposes only. There are competition law issues around potential 'gun-jumping.'

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: updating warranty disclosure is rare. Notification of possible breach is also rare. In cases of material breach, there is a right to terminate.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen, but often not quantified (other than specific warranties, e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualification is rare for private deals. It is common for private equity deals (generally not with respect to a specific group of people, but having regard to constructive knowledge and due enquiry).

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common; this is still commonly requested by buyers, but often resisted by sellers.

Is disclosure of the data room common?

Frequency/market practice: rarely; disclosure of the data room is normally requested by the seller, but resistance from the buyer is often successful.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common; it is common to contractually provide that warranties are true, correct and accurate at all times between signing and completion.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: fairly common; it is common to contractually provide that warranties are true, correct and accurate at all times between signing and completion.

Is a bring-down certificate at closing common?

Frequency/market practice: rarely; a bring-down certificate at completion is rare.

What is the applicable repetition standard, e.g., true in all material respects or material adverse effect?

Frequency/market practice: fairly common; true, correct and accurate in all material respects is common, but often carve-out for key representations and warranties (which must be true, correct and accurate without any qualification).

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: typically, it ranges from 10%-40% of the purchase price, subject to exceptions for key warranties.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: they usually apply to warranties only.

What are the common exceptions to the cap?

Frequency/market practice: key warranties are generally excepted (e.g., title, capitalization, authority). Fraud and gross negligence are also excepted. Often, other specific warranties, e.g., on tax, employment and environmental, are excepted, capped at 100% of purchase price or, sometimes, subject to specific higher caps.

Is a deductible or basket common?

Frequency/market practice: fairly common; a basket is common.

Is a de minimis common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: a general survival of 18-24 months is common.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: it is common to carve out key warranties (e.g., title, capitalization, authority, tax, employment and environmental) as well as fraud and gross negligence.

Is warranty insurance common?

Frequency/market practice: rarely; starting to see it in private equity deals.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common in more sophisticated deals.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common (net of any cost, including legal fees, for recovery of insurance proceeds).

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common (net of any cost, including legal fees, for third-party recoveries).

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: fairly common; required by law. It Is rare to reiterate such obligation in the purchase agreement.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: rarely.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes, if it is not contrary to public policy.

What is the common governing law?

Frequency/market practice: Italian law is often chosen.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is more common; national or international arbitration (usually ICC), depending on the nationality of the parties.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: in the sale of business, stamp duties are generally borne by the buyer. In the share sales, the so-called 'Tobin Tax' is statutorily borne by the buyer.

Is a separate tax covenant / indemnity or tax deed common?

Frequency/market practice: fairly common; it is common to have tax representations and warranties/relevant indemnity, usually included in the purchase agreement.

COVID-19 temporary regulations

Foreign investment restrictions

As a result of the COVID-19 emergency - pursuant to Law Decree no. 23/2020 - from April 2020 and up until 31 December 2020, in addition to the transaction triggering change of control (or the thresholds better specified in Section "Foreign investment restrictions" below) the following resolutions and transactions must be reported to the Office of the Prime Minister for prior authorization:

(a) Resolutions, deeds and transactions of entities or individuals which hold assets and contractual relationships in the Listed Sectors which trigger a change of control, ownership or availability of the said assets or the change in their designated use;

(b) The acquisition, at any title, of participations in companies that hold assets or contractual relationships in the energy, transportation and telecommunications sectors as well as in the Listed Sectors when: (i) the buyer is non-Italian, even if from another EU Member State, (ii) the purchase is of such relevance so as to cause the buyer to permanently establish in Italy as a result of the acquisition of the control of the company whose participation is being acquired. For the purposes of this rule, "control" means control via: (x) majority of votes that can be cast at shareholders' meetings; (y) sufficient number of votes so as to exercise a dominant influence at ordinary shareholders' meetings; or (z) dominant influence that is the result of particular contractual relationships between the controlling and controlled entities;

(c) The acquisition, at any title, of participations in companies that hold assets or contractual relationships in the energy, transportation and telecommunications sectors as well as in the Listed Sectors when: (i) the buyer is non-Italian and does not belong to the European Union, (ii) the acquisition grants the buyer a share of the voting rights or of the corporate capital in the acquired company equal to at least 10% (also taking into account the participations already directly or indirectly held by the buyer), and (iii) the aggregate value of the investment is equal to at least EUR 1 million. Also, acquisitions which cause the buyer to exceed 15%, 20%, 25%, and 50% of the voting rights or of the corporate capital in the acquired company must be notified to the Government.

Employment: restrictions on termination of subordinate employees.

The Italian Government has enacted provisions which limit the possibility for an employer to terminate employees for objective – business related reasons, as a way to safeguard employment levels during the COVID-19 crisis. This prohibition is currently in place until August 17, 2020. The Government is considering extending the prohibition until December 31, 2020 but no final decision has been made in this sense at the time of writing. Consequently, reorganizations and restructurings which have an impact on headcount and which require terminating employees cannot be lawfully carried out until the prohibition is lifted.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

The following issues are not the only ones to consider when entering into a private M&A transaction, but are representative of the complexity of some of the issues commonly addressed.

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Guide to Navigating Global Private M&A

Japan

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

Private companies have the option not to issue share certificates under the Companies Act. In a share acquisition involving a private company that issues share certificates, transfer of title of the shares takes place by the delivery of share certificates to the buyer. It is crucial to confirm that the seller has possession of the share certificates through the due diligence process in order to ensure a smooth closing.

If share certificates have not been issued by the company, then transfer of title of shares takes place by agreement between the transferor and the transferee. The transfer must be registered in the target company's shareholders' register in order for the transferee to be able to assert its rights as a shareholder against the company.

Pricing and payment

Foreign exchange control

Cash remittances of more than JPY 30 million into or out of Japan must be reported to the Minister of Finance ("**MoF**") through the Bank of Japan ("**BoJ**"). This reporting obligation is directed at and applicable to residents only. In practice, however, the Japanese bank usually prepares and files such report on behalf of its customers.

Signing/closing considerations

Is a deposit required?

A deposit is not common in practice as part of a share or asset sale transaction.

Is simultaneous signing/closing common?

Simultaneous and non-simultaneous signing and closing are equally common.

Approvals/registrations

Board and shareholder approvals

Share sale

Board approval by the target company's board of directors may be required where a transfer of shares is restricted under the target company's articles of incorporation and the target company has a board of directors. Such restrictions are fairly common in closely held Japanese companies. If the target company's articles of incorporation include a restriction on share transfer and the target company does not have a board, the transfer of shares will require a shareholders' resolution of the target company.

The approval of the seller's board and the buyer's board will also be required if the sale/purchase of the target's shares constitutes the disposition/acquisition of a "material asset." Further, a special resolution of the seller's shareholders is also required if:

- the target company is a subsidiary of the seller;
- the seller ceases to hold the majority of voting rights in the target after the sale; and
- the book value of the transferred shares in the target constitutes more than one-fifth of the total asset value of the seller.

Asset sale

An asset acquisition requires the approval of the seller's board if the sale constitutes the disposal of a "material asset." Whether or not a transaction involves a material asset will depend on the price of the assets, the proportion of assets being transferred relative to the target's total assets, the purpose of the transaction, the terms and conditions of the transaction and past practice.

Depending on the significance of the acquisition from the buyer's perspective, board approval may also be required from the buyer.

A special resolution of the seller's shareholders is also required if the transferred assets constitute a material part of the seller's business and the book value constitutes more than one-fifth of the total asset value of the seller.

Where the buyer purchases all of the seller's business, a special resolution of the buyer's shareholders will also be required.

Foreign investors wishing to acquire Japanese assets via a recently established Japanese subsidiary should note that if the acquisition occurs less than two years after the subsidiary's incorporation, it may be subject to the post-incorporation asset purchase rules of the Companies Act.

The general rule is that if a subsidiary that is less than two years old agrees to acquire property:

- existing before its incorporation;
- intended to be used on a continuing basis for purposes of the company's business; and
- at a price equal to 20% or more (this percentage may be lowered in the articles of incorporation) of the company's net asset value,

then a special shareholders' resolution is required to approve the asset acquisition in addition to a board resolution.

Foreign investment

Exceptional prior filing obligation

Under the Foreign Exchange and Foreign Trade Act ("**FEFTA**"), a foreign investor purchasing any number of shares in a non-listed company from a Japanese seller (such transaction referred to as an "Inward Direct Investment" under the FEFTA), either by itself or in aggregate with its related companies, must file a notification with the MoF and any other relevant minister through the BoJ within a period of six months prior to the acquisition if:

- the investor is located in a jurisdiction that is not included in the MoF list of recognized jurisdictions;
- the target company is engaged in business in a regulated industry; or
- the investor is Iranian and acquires shares in a company that operates a restricted business designated by the United Nations Security Council's resolution.

A foreign investor purchasing any number of shares in a non-listed company from a foreign seller (such transaction referred to as a "Specified Acquisition" under the FEFTA), either by itself or in aggregate with its related companies, must also file a notification with the MoF and any other relevant minister through the BoJ within a period of six months prior to the acquisition if the target company is engaged in business in a regulated industry.

The scope as to what constitutes a regulated industry differs depending on whether a foreign investor purchases the shares from a Japanese seller (i.e., an Inward Direct Investment) or a foreign seller (i.e., a Specified Acquisition). Those industries which are deemed regulated for purposes of Inward Direct Investments include weapons, aircrafts, nuclear facilities, space, dual-use technologies, cybersecurity, electricity, gas, telecommunications, water supply, railway, heat supply, broadcasting, public transportation, biological chemicals, security services, infectious disease therapeutic drug/medical device, agriculture, forestry and fisheries, oil, leather manufacture, and air transportation and maritime transportation, while industries which are deemed regulated for purposes of Specified Acquisitions are limited to weapons, aircrafts, nuclear facilities, space, dual-use technologies, cybersecurity, electricity (only to the extent related to nuclear power plants), and telecommunication businesses.

In connection with this, it should be noted that an amendment to the FEFTA effective from May 8, 2020 introduced a new exemption from the requirement of prior notification (as further explained below), together with a new concept of "core sensitive activities" to which such an exemption will not apply. Whether or not a particular sensitive activity would be deemed to constitute a "core sensitive activity" is determined based on the criteria set out in the relevant subordinate legislation of the FEFTA.

Foreign investors who are not state-owned enterprises and have no past record of sanction due to violation of the FEFTA can be exempted from the requirement of the aforementioned prior notification if such foreign investors (i) intend to acquire shares in a non-listed company whose sensitive activities do <u>not</u> include any "core sensitive activity", and (ii) satisfy all of the following conditions:

(a) such investors or their closely-related persons will not become board members or company auditors of the target company;

(b) such investors will not propose to the general shareholders' meeting any transfer or disposition of the target company's business activities in any regulated industry; and

(c) such investors will not access non-public information about the target company's technology in relation to business activities in a regulated industry.

Foreign sovereign wealth funds and public pension funds are entitled to the same exemption if they are accredited by the MoF. The MoF will take into account the following factors when determining whether to grant such accreditation to foreign sovereign wealth funds and public pension funds:

(a) whether forms of investments by such funds are purely for the purpose of obtaining economical profits; and

(b) investment decisions of such funds are made independently from those of the foreign government etc.

Where no prior notification is required by virtue of any of the exemptions described above, the foreign investor must file an after-the-fact report through the BoJ within 45 days after any purchase of shares in a non-listed company.

Where no exemption is available and the prior notification has been given, there is a 30-day waiting period during which the foreign investor may not execute the acquisition. In most cases, this waiting period may be shortened to two weeks and it may be further shortened to four business days if the proposed investment poses little national security concern.

The foreign investor is also required to submit an execution report to the MoF and any other relevant minister through the BoJ no later than 45 days after the acquisition.

General filing obligation

If the above prior filing obligation is not applicable, the foreign investor is required to file an after-the-fact report with the MoF and any other relevant minister through the BoJ no later than 45 days after the acquisition where, as a result of the acquisition of shares in a non-listed company from a Japanese seller (i.e., Inward Direct Investment), the foreign investor and its related companies in the aggregate hold 10% or more of the issued shares in the target company.

Acquisitions of shares in a non-listed company by a foreign investor from another foreign investor are not subject to this general filing obligation.

Asset sales

If a foreign investor acquires assets directly from a Japanese company by way of business transfer, company split or merger, the acquisition will be deemed an "Inward Direct Investment" and subject to basically the same exceptional prior filing obligation and general filing obligation explained above. That is, if the transferring business includes any business within a regulated industry, the foreign investor must file a notification with the MoF and any other relevant minister through the BoJ within a period of six months prior to the acquisition and may not consummate the acquisition until the waiting period has expired. The foreign investor is also required to submit an execution report to the MoF and other relevant minister through the BoJ no later than 45 days after the effective date of the acquisition.

If the prior filing obligation does not apply, the foreign investor is required to file an after-the-fact report with the MoF and any other relevant minister through the BoJ no later than 45 days after the effective date of the acquisition.

Merger control (antitrust/competition approval)

The Japan Fair Trade Commission ("**JFTC**") may review a direct or indirect acquisition of a Japanese company or business, and may order the parties to take a range of remedial steps to restore competition, including the divestiture or transfer of a business.

Under the Anti-Monopoly Act, a prior notification must be filed with the JFTC in relation to a share acquisition, an asset/business acquisition, a company split or a collective share transfer that meets certain thresholds set out in the act.

A prior notification filing prohibits the parties from effecting the transaction for a period of 30 calendar days after the filing. However, the JFTC can shorten such period. The JFTC also has power to ask the parties to submit additional information regarding the transaction.

The JFTC is prepared to clear transactions within 30 calendar days as long as they do not raise competition concerns and in particular where the parties have engaged in an extensive pre-notification process. If the JFTC requests submission of additional information during that period, the deadline for the JFTC's action may be extended by up to 120 calendar days from the date of acceptance of the notification, or 90 calendar days from the date of acceptance of the additional information, whichever is later. If the transaction gives rise to serious competition issues, it can be difficult to predict the exact timetable. In some of the past cases, clearance has taken up to 6-7 months from the filing date.

Other regulatory or government approvals

In addition to the general foreign investment regime, thresholds have been established with respect to foreign ownership in certain industries, such as airlines and broadcasting businesses under the respective industry regulations. The rules vary within these industries and should be checked at the time the acquisition is being contemplated.

In certain industries, such as banking, the parties will be required to submit a notification to, or seek consent from, the relevant regulator in relation to an acquisition.

Employment

Share sale

Employee consents are not required in a share deal. This is because an acquisition of the shares in a corporate employer will not affect its obligations to its employees since the employing entity will remain the same.

Asset sale

In an asset deal, the seller must obtain the consent of any employee that the buyer proposes to employ. Government guidelines encourage the seller to have sufficient consultation with the transferring employees to obtain informed consent.

Tax

A share purchase agreement is not subject to stamp duty in Japan.

The acquisition of assets is generally subject to stamp duty, and may be subject to real property acquisition tax and registration and license tax depending on the target assets.

Post-acquisition integration

In a cross-border deal involving a Japanese corporation, addressing cultural differences is often one of the biggest challenges. However, this issue is seldom addressed directly in the early stages of an acquisition.

Taking creative steps to rethink talent recruitment and retention is increasingly important. Putting the right people in place to drive deals as well as deploying strategic programs (such as long-term incentive plans) to prevent the unintentional loss of human capital are key elements in achieving success in integration.

Common deal structures

What are the key private M&A deal structures?

In Japan, a private acquisition usually takes the form of either a share acquisition, which involves purchasing the shares in the company that owns the business, or a business transfer, which involves purchasing the assets and liabilities of the business being acquired. However, mergers and company splits are also widely used for business acquisition purposes. While structuring the deal as a share acquisition is generally considered simpler than business or asset acquisitions, the most appropriate method to use in any particular transaction depends on a number of factors, including commercial and tax considerations, consent requirements, deal process and timing.

Similarly to other jurisdictions, auction processes are often used in Japanese deals, with the process generally explained in bid process letters prepared with the help of the seller's financial advisers. Whether non-binding indicative letters, binding offer letters, or both, are used depends on how the auction process is conducted (for example, whether the process involves a small selected group of prospective buyers or a much broader group, how the due diligence process is organized, as well as timeframe and cost considerations).

There are two types of merger available under the Companies Act:

- merger by absorption, where the acquirer takes over all of the assets and liabilities of the target company and the target company is dissolved; and
- merger by incorporation, where the assets and liabilities of both parties are acquired by a newly incorporated third party and both parties are dissolved.

Merger by absorption is by far the most common method used in Japan. A merger will usually proceed by way of an issue of shares in the surviving company to the shareholders of the target company. A merger is often used to rationalize the operations of subsidiary entities. 'Cash-out' mergers, involving mergers by absorption, are also allowed under the Companies Act.

With respect to company splits, the Companies Act provides for two types:

- an incorporation-type company split (*shinsetsu bunkatsu*), in which a new company is incorporated by operation of law and acquires the assets and liabilities divested by the company undergoing the split; and
- an absorption-type company split (*kyūshū bunkatsu*), in which an existing company acquires or absorbs' the assets and liabilities divested by the company undergoing the split.

In the context of a company split transaction, the legal term for the divesting company (the company undergoing the split) is the "splitting company" and the legal term for the company taking over the assets/liabilities from the splitting company is the "succeeding company." Company splits are often used as an alternative structure to business transfers because they are more efficient from a procedural perspective (no need to obtain third-party or employee consents) and also from a tax perspective.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

There are a number of different forms of business entity and structure available in Japan. The most commonly used are: (1) a joint-stock company, known in Japan as a "Kabushiki Kaisha" ("**KK**") and (2) a limited liability company, known in Japan as a "Gōdō Kaisha" ("**GK**").

A joint-stock company (KK) is the most commonly used form chosen by larger, more established companies for doing business in Japan. A KK is similar to a US close corporation or, when listed on a stock exchange, is akin to a US public corporation. It is also similar to the German AG corporate form.

What are the different types of limited liability companies?

A limited liability company (GK) in Japan is modelled on the US LLC. The Companies Act made significant changes as regards business entity forms and introduced this new "hybrid entity," which combines the features of a company and a partnership. For example, a GK functions like a partnership internally, but the members' liability is limited. A GK is exempt from a number of procedural requirements, such as the authorization of its articles of incorporation by a notary public.

Is there a restriction on shareholder numbers?

There are no restrictions on the number of shareholders (members) of the Japanese equivalent of a limited liability company (GK).

What are the key features of a share sale and purchase?

An acquisition of shares in a Japanese private company may be implemented by way of private agreement, whereas an acquisition of shares in a company listed on a Japanese stock exchange may trigger certain tender offer requirements under the Financial Instruments and Exchange Act ("**FIEA**") if an acquirer seeks to acquire more than one-third of the company's voting shares in an off-market transaction. A share purchase agreement is usually prepared to record the agreement of the parties over their respective rights, obligations and liabilities in connection with the transaction.

What are the key features of an asset sale and purchase?

The Companies Act recognizes two types of asset acquisition or business transfer: one that involves the transfer of 'all or a substantial part' of a Japanese company's business that requires approval by a special resolution of the shareholders, and one that does not. The distinction between the two different types of transfer is not always clear. For example, a sale by a company of a single manufacturing facility, or a single operating division or branch office, may be regarded as a transfer of a ubstantial part' of its business.

However, the question is usually determined on the basis of an objective assessment of the relative importance of the business sold compared with the company's overall business (e.g., as a proportion of the company's total amount of sales, earnings and workforce). The Companies Act indicates that a transaction would not be deemed a transfer of a 'substantial part' of a company's business if the book value of the assets being transferred is not more than one-fifth of the total assets of the seller, and the transaction will therefore be exempted from the special shareholders' resolution requirement if that is the case.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

In Japan, it is common for the buyer and the seller to prepare a letter of intent or term sheet before negotiating the definitive acquisition agreement. Except for certain matters, such as confidentiality, exclusivity, expense and similar provisions specifically identified as being binding, such preliminary documents prepared before the definitive agreement are typically not legally binding between the parties.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: Exclusivity provisions are common.
- Break fee: Break fees are not yet common, but if included, they are generally enforceable if the amount of the fees is reasonable regarding the costs and damage to the parties.
- Confidentiality: Confidentiality provisions are common.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Confidentiality letters and non-disclosure agreements are commonly used but separate exclusivity agreements are less common as exclusivity is typically dealt with in the term sheet or preliminary agreement. Break fees are not commonly used in private acquisitions.

Is there a duty or obligation to negotiate in good faith?

Broad duties to act in good faith apply to the parties. Accordingly, any failure to reach a definitive agreement caused by bad faith behavior could create legal liabilities, although such determination will be made by the Japanese courts on a totality of facts on a case-by-case basis.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: very common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: cash free/debt free and working capital are very common. NAV is fairly common.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely; collars are not common.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually prepared by the seller or the target company.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely.

Is an earn-out common?

Frequency/market practice: rarely, but most Japanese companies understand the rationale for earn-outs and show willingness to consider them if proposed by a foreign counterparty.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: rarely, but it is occasionally requested. Japanese parties are not averse to escrow but in practice it is not common, with very few local escrow service providers. Buyers may also rely on holdback.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common; this is often seen where there is a long period between execution and completion. It is more common where a Japanese buyer is involved.

Is the MAE general or specific?

Frequency/market practice: both are seen.

Is the MAE quantified?

Frequency/market practice: rarely; not sufficiently widespread to qualify as common.

Covenants

Is a non-compete common?

Frequency/market practice: they are fairly common, but not from private equity sellers.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: waterfall provisions are rarely used.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common; common (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common; common (in conjunction with a non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: it is fairly common to include specific restrictions in addition to the seller's general obligation to operate the target in the ordinary course of business.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; we generally get this for private deals.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: both are seen but it is more common to notify of possible breach (though notification is usually not deemed to constitute exception to the applicable warranty). The consequence of breach is negotiable: right to terminate or claim damages.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen but are often not quantified (other than specific warranties, e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers depend on risk-sharing in the deal. They are often limited to the actual knowledge and due enquiry of a specified list of senior management.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: rarely; it is not very common but is negotiable depending on the buyer's bargaining power and the extent of disclosed information during the course of due diligence.

Is disclosure of the data room common?

Frequency/market practice: this is becoming more common where a UK/Australian seller is involved.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: repetition at closing is common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: repetition at closing is more common.

Is a bring-down certificate at closing common?

Frequency/market practice: bring-down certificates are rarely used.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: both are seen in Japan but true in all material respects is more common.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: double materiality is negotiated but results vary.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: this depends on deal size. The buyer may ask for 100% but it is almost always negotiated down. The cap ranges from 10%-100%.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: both are seen regularly.

What are the common exceptions to the cap?

Frequency/market practice: fundamental warranties are often excepted (e.g., title, capitalization, authority). Often, tax and specific areas of concern are also excepted, sometimes with specific higher caps. Separate caps can be negotiated.

Is a deductible or basket common?

Frequency/market practice: fairly common; they are becoming more accepted in the market. Deductible is very much decided on a case-by-case basis.

Is a de minimis common?

Frequency/market practice: this is fairly common.

How long does seller liability survive?

Frequency/market practice: decided on a case-by-case basis in the range of anywhere between 6 to 36 months. If a tax indemnity is included, tax matters usually survive until a short period after SOL, i.e., the period in which tax authorities can audit the target.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: common carve-outs include fraud and certain fundamental representations and warranties (e.g., authority, capitalization, due organization and title). Other specific areas that are commonly excluded include tax and environment.

Is warranty insurance common?

Frequency/market practice: rarely; it is not so common generally, but has been used (e.g., in private equity exits) and gaining popularity.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: rarely; it is not very common but seen.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common for actually received.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common for actually received.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: rarely; it is not explicitly required by law, but courts appreciate this concept. It is sometimes express.

Is there an exclusion of consequential damages?

Frequency/market practice: this is very common but often expressed differently as there is no defined concept of 'consequential damages' in Japan.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: this is often negotiated and results vary.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes, if it is not contrary to public policy.

What is the common governing law?

Frequency/market practice: Japanese law is often chosen in any event.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: litigation is more common, usually in the Tokyo district court.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: stamp duty is not levied on share transfers.

Is a separate tax covenant / indemnity or tax deed common?

Frequency/market practice: not sufficiently widespread to qualify as common; tax deeds are rarely used.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Luxembourg

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

Legal due diligence generally covers broader matters such as corporate issues, business permits, commercial agreements, tax issues, financing agreements securities, employment and pensions matters, IP/IT and litigation, as well as for specific matters, such as for the acquisition of a real estate company or building: title deeds, lease agreements, easements, authorizations for the building and exploitation permits (in particular *commodo-incommodo* authorization).

The scope of the due diligence mainly depends on the activities and business of the target company.

Disclosure of documents and information is driven by the seller and the buyer has limited independent and external sources to obtain information.

The legal due diligence is typically limited to a review of documents in a virtual data-room combined with a Q&A exercise and management interviews. It is more and more common for a seller to provide a vendor due diligence report as part of the information granted to bidders in auction processes.

Issues identified in the due diligence are typically dealt with by either (i) having them rectified by the seller before signing/closing, or (ii) general representations and warranties in the SPA or (iii) specific indemnities.

Independent appraisal

In a typical private M&A transaction (share or asset deal) an independent appraisal is not required where the purchase price is paid in cash.

Depending on the corporate form of the companies involved in the transaction, independent appraisals may be required if the purchase price is not paid in cash but in kind through the issuance of new shares (capital contribution in kind).

Payment

There are generally no restrictions on the pricing or methods of payment of the purchase price from alegal perspective.

The purchase price can be paid in Euro or other currency, in cash or in kind, with the acquisition agreement providing for deferred payment, escrow mechanisms or for deposits.

Signing/closing

Share Sale

Share deals are commonly and frequently used in Luxembourg.

The transfer of shares does not require notarization and the share purchase agreement can be executed under private seal. The articles of association or shareholders' agreement may restrict or add additional conditions to the transfer of shares (pre-emptive rights, transfer restrictions, lock-up).

Specific formalities are provided for by law depending on the corporate form of the company whose shares are sold (e.g., specific shareholders' approval, registration in the shareholders' register).

In principle, in share deals, agreements entered into by the company remain unchanged and the company retains all its assets but also all its liabilities.

Asset Sale

In principle, in assets sales, each single asset must be transferred in compliance with the transfer and form requirements applicable to that asset. Notarization is usually not required except for real estate. Sales of real estate assets require the involvement of a public notary. The transfer deed will take the form of an authentic notarial deed and must be recorded at the Mortgage Registry to provide the owner rights of opposition against third parties.

In asset deals, business permits, licenses or contracts are in principle not transferred along with the asset except in certain cases (e.g., lease agreements in real estate, building permits and authorizations etc.). The buyer shall obtain new permits and licenses (e.g., insurance or regulatory sector).

Approvals/registrations

Foreign investment

On 7 May 2020, a new draft law establishing a framework for screening foreign direct investments ("**FDI**")[1] in Luxembourg in order to protect strategic sectors, was introduced before the Luxembourg Parliament. The draft law provides (i) a prior notification procedure to be carried out by the investor before making an investment in an enterprise, part of an enterprise, or a group of enterprises established in Luxembourg and operating in a strategic sector, (ii) administrative sanctions (fines, suspension of voting rights, etc.) and criminal sanctions in case of non-compliance by the investor of the screening procedure and (iii) judicial redress against screening decisions.

Merger control

In Luxembourg, competition is governed by EU competition regulations and the Law on Competition of 23 October 2011 ("**Competition Law**"). There is no prior merger control regime under Luxembourg law. However the Competition Law prohibits agreements and concerted practices that have as object or effect the prevention, restriction or distortion of competition and the abuse of a dominant position. Therefore under the Competition Law, mergers and acquisitions may be subject to an a posteriori control by the Luxembourg Competition Council.

Other regulatory or government approvals

Depending on the type of investments, certain approvals by the applicable Luxembourg regulator might be needed for acquisition (e.g., *Commissariat Aux Assurances, Commission de Surveillance du Secteur Financier*, etc.).

[1] "Foreign investment" is qualified as being the acquisition by the investor of a significant influence (holding directly or indirectly at least 10% of the shares or voting rights) in an enterprise, part of an enterprise, or a group of enterprises established in Luxembourg.

Employment

General

Because in a share acquisition there is no change to the employing entity, insofar as there is no change to employment conditions, no specific notification to or consent or from employees and/or staffrepresentatives is required.

When an asset deal concerns the transfer of a business (or part of a business) as a going concern, employees of the business automatically and immediately transfer to the buyer by operation of law. The parties to the transfer of business are not free to choose which employees will transfer with the business and legally, the employees transfer with all existing rights and obligations and the new employer is held to recognize the employees' previous years of service.

The buyer as the legal successor of the former employer also becomes fully liable for all employment-related liabilities. Compensation for the automatic assumption of liabilities should be addressed in the transaction documents.

Pension schemes and the transfer of pension liabilities need to be considered carefully in the transaction context.

The Labor Ministry must also be informed that all required notification formalities relating to the transfer of employees have been effectively fulfilled.

Approval or Consultation Requirements

Employers must inform the staff representatives (where applicable) of any proposed transfer of business.

If the staff headcount falls under the threshold for mandatory staff representatives, the transferor and/or transferee must notify all concerned employees in writing before the transfer. That notification must include the date of transfer, reasons for the transfer, legal, economic and social consequences of the transfer for the employees, and any measures which may be taken as a result of the transfer.

Mergers also qualify as a transfer of business triggering notification and/or consultation requirements.

Staff representatives are generally required to be informed of the proposed the business transfer's impact on employment conditions and the transfer of the employees. Reorganizations and operational changes that need to be implemented in conjunction with the transaction (e.g., split of operations, carve-outs of employees, relocations) typically impact employment conditions and trigger consultation obligations. Although the staff representation does not have a veto right, consultations may take several months and may therefore adversely impact the timing of the implementation of the proposed changes.

Terminations solely due to a "transfer of business" are prohibited by law. Terminations for other business or personal reasons remain possible.

Tax

Asset deal

Acquisition

The acquisition of assets by a Luxembourg company does not trigger any tax burden. The acquisition cost of assets from a third party is treated as the base cost of the asset. Depreciation of the assets acquired depends on the nature of the assets and their estimated lifetime. Depreciation on buildings is allowed for tax purposes and is usually based on accounting rules. Some specific guidance exists in this respect. The basis for the amortization of the acquired assets is usually the acquisition price. The acquisition costs could be tax-deductible or amortized when activated. The depreciated acquisition cost determines gains or losses arising on a subsequent disposal. However, in the event that a business is acquired from a related party at a price deemed not to be arm's length, a tax adjustment may be made.

Interest expenses incurred on a loan in relation to the acquisition are tax deductible. Attention should however be paid to the interest deduction limitation rule provided for by article 168*bis* of the Luxembourg Income Tax Law. The principle is that exceeding borrowing costs shall be deductible in the tax period in which they are incurred; only up to 30% of the taxpayer's earnings before interest, tax, depreciation and amortisation ("**EBITDA**"). Exceeding borrowing costs means the portion of interest expenses exceeding interest income.

Sale

Capital gain triggered from the disposal of assets is in principle subject to Corporate Income Tax ("**CIT**") and Municipal Business Tax ("**MBT**") at an ordinary aggregated rate of 24.94%.

Capital gains realised by individuals acting in the course of the management of their private wealth are, as a rule, exempt, unless the gains are speculative or realised in a substantial participation. A gain is speculative if realised within two years regarding real estate or six months regarding all other assets.

Capital gains on foreign real estate are generally exempt under applicable double tax treaties. Luxembourg tax law allows the temporary immunization of a capital gain derived from the disposal of a building or a non-depreciable fixed asset by accordingly reducing the acquisition price of the asset acquired by the company in lieu of the disposed building or non-depreciable fixed asset.

Provided that the proceeds of the entire sale are reinvested in the acquisition of another qualifying fixed asset at the end of the second year following the year of disposal at the latest, any capital gains realized on the disposal of the assets will not be subject immediately to taxation in Luxembourg, but will be deferred.

Finally, it is noteworthy to mention that as from 1 January 2020 exit taxation rules in relation to the transfer of assets realized upon seat migration (considered as a liquidation from a Luxembourg corporate income tax perspective) have been amended. Indeed, paragraph 127 of the Luxembourg general tax law (*Abgabenordnung*) providing the possibility to postpone payment, under certain conditions of the tax at exit indefinitely, has been changed and replaced by a payment of the exit tax over a five year period.

Indirect tax

In an asset deal, the transfer of the assets is, in principle, regarded as several distinct supplies of goods, each of which is, in principle, subject to VAT at the appropriate rate. However, no VAT is due when the sale of assets constitutes a totality of assets/business or part thereof as a going concern.

Transfer tax is among the taxes levied on the acquisition of Luxembourg real estate.

The sale of a real estate asset is subject to a 6% registration duty and 1% transcription tax. A 3% municipal surcharge is added for buildings within the Luxembourg municipality. The tax base is the market value or the consideration paid if the consideration is higher than the market value.

Legally, transfer tax is due by the acquirer. However it is customary for the buyer and the seller to agree on who will effectively bear the tax. Transfer tax is not recoverable for the buyer but is added to the cost price and subsequently (partly) amortized for corporate income tax purposes.

Transfer tax also applies in the event the sale would, for VAT purposes, be part of the transfer of going concern relief.

Share deal

Acquisition

The acquisition of shares in a company does not trigger any transfer tax.

For corporate income tax purposes, the acquired shares should be taken up in the books against cost price. Acquisition costs can be added to the fiscal cost price of the shares.

Under certain conditions, tax unity is available to achieve an efficient debt pushdown. If a Luxembourg resident company or a Luxembourg permanent establishment of a foreign company which is subject to tax corresponding to Luxembourg corporate income tax, holds directly or indirectly at least 95% of the nominal paid-up share capital of another Luxembourg resident company or Luxembourg permanent establishment of a foreign company which is subject to a tax equivalent to Luxembourg corporate income tax, both companies can, subject to certain conditions, form a fiscal unity. Within a fiscal unity, the income and costs of the members are aggregated, and this mechanism can be used to pool or offset the respective taxable profit of each company in the group and to be taxed on the global amount. When the tax consolidation regime applies, the parent company which is the "umbrella" company will pay the corporate income tax on the overall taxable profit of the consolidated companies. Under certain conditions, a horizontal tax unity is also possible between companies with the same direct or indirect parent company without the parent company forming part of the consolidation. The parent company can be a fully taxable Luxembourg share capital company, a domestic permanent establishment of a fully taxable foreign share capital company, a fully taxable EEA share capital company, or a fully taxable permanent establishment of a fully taxable EEA share capital company.

Sale

In general, capital gains are subject to the maximum statutory rate of 24.94% corporate income tax and municipal business tax for the fiscal year 2020. However, capital gains derived from shares in a qualifying subsidiary may be exempt under the conditions of the participation exemption regime. Capital losses on shares are generally deductible for Luxembourg corporate income tax purposes.

The right to tax capital gains on shares realized by a corporate non-resident acting without a permanent establishment in Luxembourg is generally allocated to the country of residence of the seller based on the applicable tax treaty.

However, if the sale of a participation in a Luxembourg company qualifying as a substantial participation is made within a period of six months after the acquisition, any gain realized upon the sale will be taxed in Luxembourg, unless a double tax treaty provides otherwise.

Merger

As a general rule, any profit realized in the context of a transfer of assets/liabilities in the case of a (de)merger is subject to Luxembourg corporate income tax. Realized hidden reserves (built-in gains), goodwill and fiscal reserves that are not retained following the (de)merger will be added to taxable profits in the year of the merger or division. However, tax law provides possibilities to realize the (de)merger in a tax-neutral way under certain conditions. Situations must therefore be analyzed on a case-by-case basis.

Indirect tax

Transactions relating to shares and participations in other companies (e.g., acquisition, holding and sale of shares) in principle fall outside the scope of VAT.

However, these transactions may fall within the VAT scope where they are performed in the context of a trading activity. In this case, transactions relating to shares will be exempt from VAT.

The traditional view is that VAT incurred on costs referable to the disposal/acquisition of shares is not deductible. However, the European Court of Justice has sometimes conceded that this VAT might be deducted where the costs incurred present a direct and immediate link to the taxable person's general activities giving right to a VAT deduction.

The deductibility of input VAT attributable to the sale/acquisition of shares or participation very much depends on the facts of each case. Therefore the setup of a share deal should be carefully reviewed to mitigate the risk of non-recoverable VAT.

Post-acquisition integration

The post-acquisition integration process is driven by the buyer's needs. The buyer generally undertakes post closing integration with respect to brand, IT, tax planning, structure reorganization (e.g., merger, liquidation, etc.), accounting in order to fully integrate the target business into its existing structure.

It is usual to insert specific clauses in the acquisition documentation to ensure that the seller will provide agreed transitional services for a certain period of time (IT, training, accounting, etc.) in order to guarantee a smooth transition and the buyer's ability to pursue the acquired business.

Common deal structures

What are the key private M&A deal structures?

In Luxembourg, a business can be acquired by way of either a share deal, under which part or all of the target's shares are transferred, or an asset deal, consisting of the purchase of some or all of the target's assets. To enhance its favorable legal environment, Luxembourg has also implemented the various European Union merger directives. Besides purely domestic mergers, Luxembourg provides for a regulatory framework for cross-border mergers in line with its characteristically open-market approach.

Cross-border mergers are possible for any merger of a Luxembourg and foreign company, and are not restricted to European Union companies, as long as the foreign jurisdiction does not prohibit the merger and the foreign company complies with the requirements and formalities of its domestic law. A merger will entail the universal transfer of all assets and liabilities of the absorbed company to the absorbing company, except in certain cases.

Auction processes are not often seen.

Bid process letters are often used under the form of letters of intent, which are generally not binding.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

The most widely used private company in Luxembourg is the private limited liability company (*société à responsabilité limitée/S.à r.l.*), which is used by around two-thirds of companies in Luxembourg.

What are the different types of limited liability companies?

- the private limited liability company (*société à responsabilité limitée*) — SARL
- the public limited liability company (*société anonyme*) — S.A.
- the simplified joint stock company (*société par actions simplifiée*) — S.A.S.
- the corporate partnership limited by shares (*société en commandite par actions*) — S.C.A.
- the common limited partnership (*société en commandite simple*) — S.C.S.

Is there a restriction on shareholder numbers?

The number of shareholders of a SARL is limited to 100.

What are the key features of a share sale and purchase?

In principle, the shares are freely transferable. However, the articles of association of the company or an agreement entered between the shareholders can limit the transferability of the shares.

In the case of the transfer of shares in a SARL to a non-existing shareholder, the Luxembourg law on commercial companies provides that such transfer requires the prior approval of the current shareholders representing 75% of the company's share capital. It is possible to reduce this majority to 50% in the articles. A share purchase agreement is prepared to record the agreement of the parties on their respective rights, obligations and liabilities in connection with the transaction. No specific form of agreement is prescribed under Luxembourg law.

What are the key features of an asset sale and purchase?

When a business is transferred by way of an asset purchase, each individual asset needs to be transferred in accordance with the formalities for a transfer applicable to that type of asset. For some assets, this will simply be a case of delivering the asset to the buyer, but in other cases the formalities are more cumbersome (e.g., requiring filing the transfer in respect of trademarks and patents; or for real estate the additional step of executing the purchase agreement before a notary public in Luxembourg, update of the land registry (cadastre) and filing of the notarial deed with the mortgage registry (*conservation des hypothèques*)). The assignment of contracts under an asset purchase could also raise issues of third-party consent, while in a share deal, third-party consent is needed only for agreements that have a change of control clause. It is therefore necessary to include a provision, either in the purchase agreement or in separate agreements, requiring those formalities to be complied with. There will usually be an asset purchase agreement to record the respective rights, obligations and liabilities of the parties.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

It is customary to prepare letters of intent or term sheets, which are, however, generally non-binding.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: It is customary to have exclusivity provisions in a term sheet.
- Break fee: Break fee provisions are rarely used.
- Confidentiality: It is customary to have confidentiality clauses in a term sheet.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Separately negotiated agreements are not often used except for non-disclosure agreements to a certain extent.

Is there a duty or obligation to negotiate in good faith?

A party in breach of acting in good faith may be liable for damages. Under Luxembourg law, parties negotiating a transaction, including a sale of shares, assets or business, are under a general obligation to conduct the negotiations in good faith. This entails, among other things, that negotiations that are at a reasonably advanced stage where a party can reasonably expect that a transaction will occur cannot, in principle, be terminated abusively. In the case of abusive termination of the negotiation, damages may be granted.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: purchase price adjustments are common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: cash-free debt-free or NAV adjustments are common. An expert is often appointed where there is disagreement between the parties.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is often prepared by the seller, and responsibility is to be agreed by both seller and buyer.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely.

Is an earn-out common?

Frequency/market practice: earn-outs are rarely used, except in transactions where the seller continues to manage the target company after closing.

Is a deposit common?

Frequency/market practice: fairly common.

Is an escrow common?

Frequency/market practice: escrow is frequently used to secure purchase price adjustments or indemnification obligations. Escrow is also used to secure post-closing obligations of the seller.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: common but only in cases where signing and closing are separated by a long period of time (i.e., several months).

Is the MAE general or specific?

Frequency/market practice: both seen but specific is more common.

Is the MAE quantified?

Frequency/market practice: fairly common.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: rarely, waterfall/blue pencil provisions are not common but sometimes seen.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: common (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: common (in conjunction with a non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common; specific covenants of the seller are often included in the share purchase agreements in order to ensure that the seller will not make certain operations that will decrease the company's value.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: rarely; access is usually granted only until signing.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: fairly common; updating warranty disclosure is common until signing. After signing, the party in breach must normally notify the other party. Remedies are possible depending on the materiality of the breach: either indemnification solely or termination plus indemnification are seen.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common, materiality qualifiers are often used but often not quantified.

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are common and are generally not limited to specified persons.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common.

Is disclosure of the data room common?

Frequency/market practice: fairly common.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common; repetition of the representations and warranties at completion is common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: fairly common.

Is a bring-down certificate at closing common?

Frequency/market practice: rarely; a bring-down certificate at completion is not uncommon.

What is the applicable repetition standard e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate in all material respects is common but fundamental representations must be absolutely true.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: this differs largely, subject to negotiations and the assets.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: they usually only apply to warranties only.

What are the common exceptions to the cap?

Frequency/market practice: indemnification related to title/fraud/environment is usually not capped.

Is a deductible or basket common?

Frequency/market practice: both are common.

Is a de minimis common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: from 12 to 36 months for general representations and warranties except for tax and social security matters, for which legal limitations usually apply.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: unlimited for fraud.

Is warranty insurance common?

Frequency/market practice: rarely.

Reliance

Do financiers seek to rely on buyer due diligence reports?

Frequency/market practice: fairly common.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common, often as regards VAT.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: fairly common.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: fairly common.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes, if it is not contrary to public policy.

What is the common governing law?

Frequency/market practice: in general, Luxembourg law is chosen for Luxembourg targets.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: litigation is more common; arbitration is rare.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: there is no stamp duty. However, Luxembourg courts may require prior registration of a purchase agreement with the tax administration (*Administration de l'Enregistrement, des Domaines, et de la TVA*) in Luxembourg, in which case a fixed registration fee of EUR 12 is payable.

Is a separate tax covenant / indemnity or tax deed common?

Frequency/market practice: very common; usually covers the fact that the target is up to date in terms of tax declarations, and that declarations are certified true, correct and complete.

Global deal points study

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Guide to Navigating Global Private M&A

Malaysia

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

The regulatory regime can appear to be disorderly due to the intricate interplay of rules and regulations that are subject to government policy relating to the industry in which the target company is operating.

Not all governmental policies are in written form and guidelines or directives may not be publicly available for inspection. It is therefore common as part of due diligence to contact regulators to confirm the latest policy positions. It is also common for companies to hold "grandfathered" licenses that may not reflect the latest policy positions (for example, the shareholding structure may not reflect the latest equity conditions if an application for a new license is to be made today). This will present difficulties in a share sale that is likely to trigger regulatory approval as a result of the proposed share transfer.

It is important to inspect the internal documents of the target company and not rely on public searches. Information obtained from searches conducted on public registers maintained by governmental or other regulatory authorities may not be current (due to delays in updating information) or may not be accurately recorded in those registers by the relevant authorities.

There is no centralized database from which litigation searches may be conducted. However, searches may be conducted at the relevant court registers if the buyer has details of the relevant litigation proceedings.

Pricing and payment

Foreign exchange control

Share sale

A resident is allowed to make or receive payment in ringgit or foreign currency in Malaysia to or from a non-resident for the settlement of shares in a Malaysian company.

Asset sale

In an asset sale, unless the foreign buyer already has an existing entity in Malaysia, a foreign buyer must first incorporate a local company or, if the buyer is a foreign company, register a branch with the Companies Commission of Malaysia prior to undertaking the business of the transferred assets.

The registered branch of a foreign company is treated as a resident for exchange control purposes. Payment between residents for a Malaysian asset must be made in the Malaysian local currency (Malaysian ringgit).

Signing/closing considerations

Is a deposit required?

The payment of a deposit is common practice for a share sale or asset sale.

Is simultaneous signing/closing common?

Simultaneous signing and closing is not common for the following reasons:

(a) most industries are regulated and regulatory approvals are typically required for an asset sale or share sale; the approval process can often be lengthy and involve several regulatory bodies;

(b) licenses are not transferable and the buyer in an asset sale will have to apply for new licenses, permits or approvals to carry on the transferred business prior to closing; and

(c) unless the foreign buyer already has an existing entity in Malaysia to acquire the assets, a new entity needs to be incorporated, which will result in a gap between signing and closing in an asset sale.

It is possible for signing and closing to occur simultaneously in instances where no regulatory approvals or other conditions precedent are required.

Approvals/registrations

Foreign investment

Share sale

There is no overriding legislation, policy or regulatory body imposing restrictions on foreign investment in Malaysia. However, foreign equity restrictions are imposed on certain industries (such as banking, insurance, aviation, energy and infrastructure) by the relevant industry regulator through the grant and administration of licenses, permits or other governmental approvals.

It is possible for foreign equity restrictions to be imposed as a condition to qualify for any government-related tenders or concessions.

Asset sale

Licenses, permits or government approvals may require the approval of the relevant industry regulator for the disposal of assets by the licensed or regulated entity.

The approval of the Economic Planning Unit ("**EPU**") of the Prime Minister Department is required in respect of real property transactions resulting in the dilution of Bumiputera (i.e., the indigenous people of Malaysia) and/or government interests in real property.

Direct acquisition: Where there is a dilution of Bumiputera or government interest in real property and the property is valued at MYR 20 million and above.

Indirect acquisition: Where there is indirect acquisition of real property by a foreign interest through acquisition of shares if:

- the transaction results in a change of control of the company owned by Bumiputera interest and/or government agency;
- real property makes up more than 50% of the company's assets; and
- the real property is valued at more than MYR 20 million.

Where approval is required, a 30% Bumiputera equity condition will be imposed in the shareholding of the property holding company. As the requirement to obtain approval is merely a reflection of governmental policy, there are no legal sanctions against non-compliance with the guidelines. However, failure to obtain approval may result in the land office not processing the transfer of properties.

Merger control (antitrust/competition approval)

There is currently no merger control regime in Malaysia (except in respect of selected limited industries such as the civil aviation and telecommunications industry) and no merger control filings are required by the Malaysian Competition Commission ("**MyCC**") in connection with a share sale or asset sale.

The MyCC enforces the Competition Act 2010, which regulates agreements between companies that have (a) the object or effect of significantly preventing, restricting or distorting competition in any market for goods or services in Malaysia; or (b) conduct which amounts to abuse of dominance in the relevant market.

Other regulatory or government approvals

Generally, it is government policy (rather than statute) that limits acquisitions in specific industries, although certain Malaysian legislation sets caps on foreign equity participation in Malaysian companies operating in particular industries.

An example is that foreign business operators engaged in 'distributive trade services' in Malaysia are recommended to obtain the approval of the Ministry of Domestic Trade and Consumer Affairs ("**MDTCA**") before commencing operations under its Guidelines on Foreign Participation in the Distributive Trade Services Malaysia 2020 ("**DTG**"). There are shareholding restrictions depending on the format of distribution (such as hypermarkets and convenience stores).

The DTG is not law and represents the Malaysian government's current policy. Although there are no legal sanctions against non-compliance, the DTG is enforced administratively via refusal to register new business branches of foreign companies, or through licensing restrictions and the issuance of immigration passes.

Employment

Share sale

In a share sale, there is no change of employer as the employees remain employed by the target company post share sale. As such, no employees' consents are required.

Asset sale

There is no automatic transfer of employees in a business or asset sale in Malaysia, and an employer cannot unilaterally transfer an employee to another employer without the consent of the employee. The employees must either resign or be terminated by the seller and offered new employment by the buyer.

Where the employees fall within the ambit of the Malaysian Employment Act (i.e., employees who earn MYR 2,000 per month or less, or those engaged in specified work (e.g., manual labor, supervising manual labor or operating a motor vehicle) regardless of wages), a minimum termination notice is required and payment of termination benefits may be required.

Tax

Share sale

The following taxes are applicable in a share sale:

- Stamp duty is payable on the share transfer form, being the instrument of transfer (and not thedefinitive agreement), at a rate of 0.3% of the consideration price or market value of the shares (calculated based on the higher of (a) the net tangible assets ("**NTA**") value; or (b) the price earnings ratios ("**PER**") at a multiple depending on the industry), whichever is higher.

- Real property gains tax ("**RPGT**") - Please see below in respect of RPC Shares.

Asset sale

The following taxes are applicable in an asset sale:

- Stamp duty is levied on the instruments of transfer (such as an asset transfer agreement or assignment agreement) at an ad valorem rate of 1% on the first MYR 100,000, 2% on the next MYR 400,000, 3% on the next MYR 500,000, and 4% on any amount in excess of MYR 1,000,000 on the balance of the market value of the property or the consideration given for it, whichever is higher. The instrument of transfer must be submitted to the stamp office for adjudication within (a) 30 days of the date of execution if executed in Malaysia; or (b) 30 days after it was received in Malaysia if executed outside of Malaysia. The stamp duty must be paid within 30 days from the date of the notice of assessment issued by the stamp office.
- RPGT is imposed on gains arising from the disposal of real properties or the disposal of shares in a real property company (i.e., where real property forms 75% or more of the tangible assets of such company) ("**RPC Shares**") at a sliding rate of 5% – 30% depending on the holding period of the real property and whether or not the seller is a company incorporated in Malaysia, a citizen or a permanent resident. Where RPGT is payable, (a) the buyer must retain 3% of the purchase price (7% if the seller is not a citizen, permanent resident or a company incorporated in Malaysia) and pay such amount to the IRB within 60 days of the disposal of the real property or the RPC Shares ("**Date of Disposal**"); and (b) both the seller and buyer must file returns for the RPGT in the forms prescribed by the IRB to the IRB within 60 days from the Date of Disposal.

Post-acquisition integration

N/A

Common deal structures

What are the key private M&A deal structures?

As in other jurisdictions, the acquisition of a business in Malaysia may be structured as either a sale of shares or a sale of assets (or a combination of the two). In particular, the buyer may purchase the shares of the company operating the business from its shareholders or purchase the assets of the business directly from that company.

Auction processes are not uncommon in Malaysia and are becoming increasingly prevalent, especially when they involve significant target businesses. They are *de rigeur* for businesses being sold by private equity firms and large corporations. Bid letters are widely used to regulate the auction process. Typically, the sellers may require the bidders to submit a non-binding indicative bid based on limited information, to be followed by a final binding bid upon completion of a reasonably extensive due diligence exercise.

Malaysia has long had provisions in its Companies Act for schemes of arrangement. These were originally modelled on the UK Companies Act 1948 and they have remained largely intact under the current version of the Companies Act (which came into effect in January 2017). The scheme involves a court-convened meeting to approve the scheme followed by the sanction of the High Court if requisite majorities are obtained at the court-convened meeting. The Companies Act also contains provisions to facilitate schemes of amalgamation of companies, which are often used in corporate reorganizations.

In addition to the sale of shares, assets or businesses, and schemes of arrangement and amalgamation, there are also provisions in certain statutes (such as the Financial Services Act and the Capital Markets and Services Act) that enable the transfer of assets and liabilities through vesting orders issued by a court following approval of the transaction by the sectoral regulatory authority. The foregoing methods of effecting mergers often involve one or more of the following:

- the transfer of one company's business assets to another company, followed by the liquidation or disposal of the transferor company;
- the establishment of a new company that acquires the assets of two or more entities which, following the transfer of assets, are liquidated or disposed of; or
- the transfer of the shares in one company (Company A) to another company (Company B), followed by the liquidation of Company A and a distribution of its assets in its present form (in specie) to Company B.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

Under the CA 2016, a company may be either limited by shares, limited by guarantee or an unlimited company. The usual form of a subsidiary company is a company limited by shares. If a company is limited by shares, the liability of its members (shareholders) is limited to the amount, if any, unpaid on their shares.

What are the different types of limited liability companies?

Companies limited by shares and companies limited by guarantee.

Is there a restriction on shareholder numbers?

The limit of the number of members is 50 (exclusive of employee members) for private companies. There is no limit for public companies.

What are the key features of a share sale and purchase?

A share acquisition is generally simpler to implement from both the seller's and buyer's point of view. A share acquisition involves the transfer of ownership of only the shares in the target company, which, as a matter of Malaysian law, is a relatively straightforward process. It also provides continuity of the business for the buyer and a clean break for the seller.

What are the key features of an asset sale and purchase?

An asset sale involves the identification of, and transfer of title to, specific assets or categories of asset, and as such is generally more complicated. The target's assets will commonly include land and premises, inventory and work-in-progress, book debts, intellectual property rights, goodwill, insurance, leasing, hire purchase and other contracts, and plant and machinery. It is therefore often necessary to transfer each asset or category of asset from the target to the buyer by way of different conveyances, assignments and transfers that, in some instances, will also require consents from third parties not directly involved in the transaction. New permits or authorizations may also be required to carry on the business. The transfer of assets also raises additional concerns in relation to the employees of the business.

One of the main advantages of an asset acquisition is that the buyer may pick and choose specific assets or liabilities to be purchased or assumed, leaving behind those assets and liabilities that it does not require. The asset buyer will not generally inherit the target company's liabilities unless those liabilities are specifically acquired.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

It is not uncommon for parties to enter into a term sheet or a letter of intent to set out the commercial terms of the transaction. Such terms are not typically binding, but parties will often provide for certain binding terms, e.g., confidentiality and exclusivity.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: Exclusivity provisions are commonly included in terms sheets/letters of intent.
- Break fee: Break fees are not common provisions in term sheets/letters of intent. In Malaysia, deposits are more common, that is, the seller will request the buyer to pay a deposit at the time of execution of the transaction as part of the purchase price. It is rare for the seller to ask for payment of a break fee.
- Confidentiality: Confidentiality provisions are commonly included in term sheets/letters of intent.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Once the term sheet has been signed and the parties progress to a definitive agreement, the agreement will usually have a confidentiality clause. The definitive agreement will not usually have an exclusivity clause because it is not necessary as the agreement represents a binding legal commitment to conclude the transaction on the basis of the terms of the agreement. Break fee clauses are not common in Malaysia.

Is there a duty or obligation to negotiate in good faith?

There is no general duty or obligation to act in good faith, unless provided for in the term sheet or letter of intent (which is uncommon). Similarly, it is uncommon for parties to agree, in a term sheet or letter of intent, on "break fees" payable in the event that the sale and purchase agreement is not entered into. However, if a party breaches any of the binding terms under the term sheet or letter of intent, the party will be liable for breach of contract. It is, however, customary for a seller to ask for a deposit of up to 10% of the purchase price to be paid by the purchaser upon the execution of the purchase agreement, which may be forfeited by the seller if the transaction does not complete due to the non-performance of the purchaser's obligations.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: very common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: cash free/debt free and working capital are very common. NAV is fairly common. The type of adjustment (whether based on EBITDA, EV, NAV, etc.) will typically depend on the industry, type of business and stage of the target's business lifecycle.

Is there a collar on the purchase price adjustment?

Frequency/market practice: collars are rarely used.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually prepared by the target company (but the buyer may be involved in the process of preparing the accounts).

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely; only generally used in private equity transactions with continuing management.

Is an earn-out common?

Frequency/market practice: it is fairly commonly requested but foreign purchasers will typically push back. Earn-outs are commonly capped.

Is a deposit common?

Frequency/market practice: it is fairly commonly requested but foreign purchasers will typically push back.

Is an escrow common?

Frequency/market practice: it is fairly common to have an escrow arrangement where a deposit is payable. It is less common to have a deposit used as a break fee.

Is a break fee common?

Frequency/market practice: rarely; but seen occasionally.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: rarely; though it is increasingly used in the context of targets exposed to significant risks.

Is the MAE general or specific?

Frequency/market practice: both are seen; increasingly more specific.

Is the MAE quantified?

Frequency/market practice: rarely; but increasingly more common.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common; it is more common for sales of businesses. There may be enforceability issues if used in share sales, as it may be a restraint of trade.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: yes it is common to use a blue pencil method as long as the parties include an express provision to such effect. If the parties do not include such a provision, then a court may still interpret the terms of the agreement based on the intention of both parties and taking the facts and circumstances of the transaction into account.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common (in conjunction with a non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: it is fairly common for parties to agree on certain pre-completion covenants.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; this is generally seen in private company deals.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: rarely; notification of possible breach is common. Where there is a material breach; there is a right to rescind.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen but often not quantified (other than specific warranties, e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are increasingly common. They are often limited to the actual knowledge and due enquiry of a specified list of senior management personnel.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: rarely; sellers are increasingly resisting information warranties.

Is disclosure of the data room common?

Frequency/market practice: this is becoming increasingly common.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: repetition at completion is common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: it is rare to repeat warranties at all times between signing and completion (unless the purchaser is in a very strong bargaining position relative to the seller). Well-advised sellers will always try to resist repeating the warranties at all times between signing and completion.

Is a bring-down certificate at closing common?

Frequency/market practice: bring-down certificates are not common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate in all material respects is common but there will often be carve-outs for fundamental representations which must be absolutely true.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely; double materiality is usually avoided.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: title and capacity warranties are usually uncapped or capped at 100%. Business and operational warranties are often in the range of 20%-50%.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: warranties only; sellers with a strong bargaining position (typically in auction processes) do ask for the cap to apply to the whole agreement.

What are the common exceptions to the cap?

Frequency/market practice: key warranties are often excepted (e.g., title, capitalization, authority). Tax and other specific areas of concern may also be excepted or specific higher caps may be applied. Separate caps can be negotiated.

Is a deductible or basket common?

Frequency/market practice: fairly common; this is determined on a case-by-case basis, and depends on the industry and target in question.

Is a de minimis common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: a general survival of 18-24 months is common, tied to 1-2 audit cycles. Tax is commonly seven years, which ties to the tax audit statutory limitation period.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: it is common to carve-out fraud.

Is warranty insurance common?

Frequency/market practice: generally uncommon but parties are increasingly considering it, particularly in private equity deals.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: not commonly seen.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common for proceeds actually received.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common for proceeds actually received.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: not usually express, but required by law.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: it is fairly common that purchasers will limit knowledge to matters referred to in the agreed bundle of due diligence documents, the purchase agreement and the disclosure letter and that otherwise the purchaser's knowledge does not affect the ability to make warranty or indemnity claims.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: Malaysian law.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: on balance, arbitration is more common. Foreign parties prefer arbitration outside Malaysia, usually Singapore, Hong Kong or London.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: the buyer, by law, pays the stamp duty, and it is unusual to agree otherwise. The rate is 0.3% of the purchase price or market value of the transacted shares.

Is a separate tax covenant / indemnity or tax deed common?

Frequency/market practice: it is fairly common to have tax indemnities, usually included in the purchase agreement.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Mexico

Quick reference guide

Due diligence, pricing and closing

Due diligence

In Mexico, a variety of issues typically arise during the due diligence process, depending on the type of transaction, the industry in question, and other factors. Compliance with relevant Mexican laws and regulations is particularly important with respect to tax, customs, environmental, and labor matters, as well as real estate and data privacy. Any pending litigation or other proceedings should be reviewed carefully, as well as possible non-payment of taxes or other fees. A careful review of the seller's corporate records should be conducted, checking to make sure that government filings are up to date and that required corporate procedures have been followed. Compliance and anticorruption practices should be a focus of any due diligence investigation, particularly any bribery and kickbacks, as well as possible fraud in the workplace.

These types of due diligence issues often mean additional costs post-closing. Because such costs can decrease the value of the transaction, the buyer may seek protection through a purchase price reduction or other means. In addition, asking the seller to respond to issues raised during the due diligence process would be considered standard.

Pricing and payment

Parties freely negotiate price and payment conditions. However, it is important to be cautious with respect to the antitrust rules described in further detail herein regarding information exchange during any negotiations to avoid the appearance of collusion.

Signing/closing

There is no deposit required. Signing and closing are frequently independent from one another. Between the signing and the closing date, it is common to obtain authorizations or complete closing conditions. In some instances, the buyer may undertake additional due diligence, particularly involving legal and financial matters.

Approvals/registrations

Foreign investment

The following activities are exclusively reserved for Mexican nationals or Mexican companies with foreign exclusion clause (a clause in the bylaws making foreigners subject to Mexican laws): transportation of land passengers, tourism and cargo; development banks; certain professional and technical services.

Foreign investors cannot participate in the companies described above through trusts, agreements, pyramid schemes or other mechanisms providing any participation or control in the company.

Foreign investors may hold up to a:

(i) 10% interest in production cooperatives companies (special type of company comprised entirely by individuals and based on common interests and the principles of solidarity, self-effort and mutual aid, with the purpose of satisfying individual and collective needs, through the realization of economic activities of production, distribution and consumption of goods and services, which are regulated by a specific law different from the one applicable to commercial companies); or

(ii) 49% interest in companies engaged in the following activities: (a) manufacturing and commercialization of explosive, firearms, cartridges, ammunitions; (b) printing and publication of domestic newspapers; (c) Series "T" shares in companies owning land used for agriculture, livestock or forestry purposes; (d) fresh water, coastal and exclusive economic zone fishing, not including fisheries; (e) integral port administration; (f) port pilot services for inland navigation under the terms of the law governing the matter; (g) shipping companies engaged in commercial exploitation of ships for inland and coastal navigation, excluding tourism, cruises and exploitation of marine dredges and devices for port construction, conservation and operation; (h) supply of fuel and lubricants for ships, airplanes and railway equipment; (i) broadcasting. This maximum foreign investment will be subject to the reciprocity that exists in the country of constitution of the investor or economic agent who exercise control, in the last instance, directly or indirectly; and (j) scheduled and non-scheduled domestic air transport service; non-scheduled international air transport service in air taxi modality; and specialized air transport service. These limits on foreign investment shall not be exceeded directly or through trust, social agreements, pyramid schemes or any other mechanisms providing any participation in the company or control of the company above the 10% or 49% threshold as applicable.

The approval of the Foreign Investment Commission ("**FIC**") is required for a participation higher than 49% in the following activities or companies: port services for interior navigation vessels; naval companies dedicated exclusively to high traffic vessel operations; aerodrome public services licensees or authorized companies; private educational services from pre-school to high school; railway construction, operation and exploitation.

Notwithstanding the activity in which they are engaged, approval from the FIC is required for Mexican companies where foreign investors participate directly or indirectly in a proportion higher than 49% of the social capital, when the total value of assets is higher than the amount set by the FIC on an annual basis. On 8 May 2020, the FIC determined this value to be MXN 20,184,671,346.26 (approximately USD 929,090,243) (at an exchange rate of USD$ 1 per MXN 21.7252 peso).

Merger control

Pursuant to the General Law of Commercial Companies (*Ley General de Sociedades Mercantiles*), merger transactions must be registered with the Public Registry of Commerce and published in the Official Journal from the jurisdiction where each company is domiciled. Each company must publish its most recent balance sheet. In addition, the entity that will be eliminated pursuant to the merger must publish the process for extinguishing all debts.

The proposed merger may not take place until three months after the above-mentioned registration. During that period, any creditor from either one of the merging companies may judicially oppose the merger through a brief procedure. The merger will be suspended until a judge has reached a decision.

However, the merger will be effective from the registration date, if it agreed the payment of all debts of the merging companies, or if a deposit is provided in the amount, with a financial institution or if all creditors have had provided their consent to the merger transaction. The deposit certificate shall be published in the Official Journal though the same procedure described above.

The merging parties shall also notify the merger control authorities if and when the following thresholds are met:

- when the transaction(s) are valued at 18 million x Measure Units (MU) (= MXN $1,563,840,000, approximately USD $71 million), regardless of where the transaction is executed;
- when the transaction(s) involve an accumulation of 35% or more of the assets or shares of an entity, with annual sales originated in Mexico or assets in Mexico importing more than the equivalent of 18 million x MU (= MXN $1,563,840,000, approximately USD $71 million); and
- when the transaction(s) involve the accumulation in Mexico of assets or equity higher than 8.4 million x MU (= MXN $729,792,000, approximately USD $33.2 million) and if because of the merger, two or more economic agents with annual sales originated in Mexico or assets in Mexico, jointly or separately, exceed more than 48 million x MU (= MXN 4,170,240,000, approximately USD $189.5 million).

Other regulatory or government approvals

M&A transactions in regulated industries, such as in the telecommunications and financial services sectors, need to follow special approval procedures.

Employment

Share sale: When a business is transferred through a stock purchase, the transaction will not involve a change of employer. Therefore, labor conditions, as well as employee benefits and compensation are unaffected. Consent from employees or labor unions, if applicable, is not required. In addition, there is no need to notify employees.

Asset sale: If the transaction is structured as an asset purchase that entails the transfer of personnel, it would be considered as an employer substitution, which would start six months as of the date of when the employees have been notified of the transaction. Therefore, it is advisable to determine in advance which party will be required to compensate the employees and notify the union, if applicable.

Tax

Spin-offs are considered a transfer of assets for tax purposes. However, no taxation would be triggered by the transfer of assets through a spin-off process if certain formal requirements are properly and timely met: the shareholders who also own at least 51% of voting stock of the companies involved remain the same for one year prior to the spin-off and two years after said process is finished.

In the case of an asset deal, corporate income tax ("**CIT**") applies to the net profits derived by sellers that are Mexican entities. The base of the tax is equal to the income subject to tax minus allowable deductions and carry-forward losses ("**NOLs**"). Some expenses, such as certain taxes, conventional penalties and goodwill, are not allowed as deductions. gains realized by legal entities in Mexico upon the transfer of assets are taxed as ordinary income at a 30% general CIT rate. The gains realized can be fully offset by carry-forward losses without any limitation, and tax losses can be carried-forward for up to a 10-year period.

VAT at a rate of 16% also applies on all transfers of assets carried out within Mexican territory. Transfer taxes may be triggered on the transfer of certain assets, for instance, ISAI is a local tax due on the transfer of real estate. This tax (ranging from 2% to 4.5%) may be charged on an asset deal that involves real estate acquisition.

The gains derived by a non-resident shareholder upon the transfer of shares are treated as Mexican source income in cases where (a) the issuer of the shares is a legal entity resident of Mexico for tax purposes or (b) the book value of the shares (regardless of the tax residency of the issuer of such shares) is derived from more than 50% from immovable property located in Mexico. As such, foreign residents who sell shares of

Mexican companies are subject to a 25% tax on the gross proceeds from the sale, or, at the option of the foreign resident if it has a local representative in Mexico, to a 35% tax on the net gain derived from the sale. This option is not available to foreign sellers domiciled in tax haven jurisdictions. Under certain conditions, tax rulings may be available to defer payment of taxes when transferring shares in reorganizations between members of the same group of companies.

Finally, although a merger is generally regarded as a taxable event, it will qualify as a tax-free transaction if the following formal requirements are properly and timely met: (i) notice must be filed by the surviving entity within the month following the merger; (ii) during a minimum one year period following the date of merger, the surviving entity must continue carrying out the activities in which it and the disappearing entity were engaged prior to the merger; and (iii) the surviving entity or the newly created entity must timely file the income tax return and tax informative return corresponding to the disappearing entity for the tax year of the merger. A tax notice would have to be filed prior to the merger date if any entity participating in the merger participated in any merger or spin-off during the last five years.

Post-acquisition integration

N/A

Common deal structures

What are the key private M&A deal structures?

In Mexico, a business can be purchased by way of a share purchase, an asset purchase, a merger or a combination of those transactions.

Each structure has specific issues that need to be considered by the seller and the buyer during the negotiation process. Certain key differences between a share acquisition and an asset acquisition include the following:

The principal distinction between an asset and a share acquisition is that, for share acquisitions, the buyer will assume the entire liability from the target company. In contrast, in an asset acquisition, the buyer will generally only absorb liability with respect to the assets acquired (subject to an exception with respect to the acquisition of a business as a going concern).

In an asset transaction, the seller might need to obtain consent from a contracting party to transfer certain contracts to the buyer. In a share acquisition, contracts are generally unaffected by the transfer of shares, unless the contract contains a change of control provision. Similarly, licenses, permits and authorizations of a target company will remain unaltered and typically may be transferred without change in a share acquisition. In an asset acquisition, certain permits and authorizations held by the target company could be difficult to transfer because of the need to obtain consents from the issuing government agencies. In some cases, it will be necessary to obtain a new permit or authorization.

Because in an asset acquisition the buyer may choose those assets it wishes to acquire and those liabilities it wishes to assume, due diligence in an asset acquisition is generally narrower, as it usually involves verifying title to the corresponding asset(s) and the seller's compliance with legal requirements applicable to the import, use or sale of the relevant assets. In contrast, due diligence in a stock acquisition context requires a complete and comprehensive review of the affairs of the target company to limit the risk that the buyer might assume liabilities that it does not wish to assume.

Under Mexican law, two or more entities can merge either by integration or by absorption. A merger by integration involves the formation of a new entity by one or more entities, which merge, integrate and consolidate with a new entity, resulting in the extinction of the integrated entities. In a merger by absorption, two or more entities merge into one, which will be the resulting entity. The merged entities are extinguished and cease to exist upon transfer of their assets, liabilities and capital to the surviving or resulting entity.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

Among the most commonly used forms of business organization regulated by the General Law of Commercial Companies ("**GLCC**"), are:

- corporations:
  - *Sociedad Anónima* (S.A.); or
  - *Sociedad Anónima de Capital Variable* (S.A. de C.V.)
- *Sociedad Anónima Promotora de Inversión de Capital Variable* (S.A.P.I. de C.V.); and
- limited liability companies:

- *Sociedad de Responsabilidad Limitada* (S. de R.L.) and
- *Sociedad de Responsabilidad Limitada de Capital Variable* (S. de R.L. de C.V.);

Foreign investors, particularly US investors, frequently incorporate limited liability companies because this form of business organization provides limited liability to its partners and certain benefits for US income tax purposes (as they are considered pass-through entities). Corporations, however, are by far the most common form of business organization used in Mexico.

What are the different types of limited liability companies?

There are two different types of limited liability companies:

- *Sociedad de Responsabilidad Limitada* (S. de R.L.); or
- *Sociedad de Responsabilidad Limitada de Capital Variable* (S. de R.L. de C.V.).

These entities offer limited liability, which means that the shareholders or members are insulated from liability up to the amount of their contributions at the entity level.

Limited liability companies are formed by partners who are obligated to pay only their contributions. In contrast to a corporation, the partners' contributions are only represented by quotas, which do not constitute negotiable instruments. The transfer of quotas and admission of new partners is subject to approval of the majority of the partners in the company.

Is there a restriction on shareholder numbers?

The maximum number of partners in an S. de R.L. or an S. de R.L. de C.V. may not exceed 50.

What are the key features of a share sale and purchase?

Generally, all that is required to transfer legal title to the shares in a stock corporation (S.A. de C.V.) is:

- execution of a stock/share transfer agreement;
- endorsement and delivery to the buyer of the relevant stock certificate(s); and
- registration of the new shareholder in the company's stock registry book.

Similar requirements apply to the acquisition of membership interests in limited liability companies (S. de R.L. de C.V.), except that:

- the majority of members of the company must consent with the transfer of quotas and the admission of new partners; and
- the endorsement of the equity certificate is not required since a S. de R.L. de C.V. does not issue negotiable stock certificates.

What are the key features of an asset sale and purchase?

Asset transfers are typically documented in an asset purchase agreement ("**APA**"). The APA must follow the requirements applicable to the transfer of those particular assets. Asset transfers usually require the issuance of an official tax invoice in accordance with Mexican tax laws. The transfer of ownership of real estate requires a notarial deed prepared by a notary public and its registration with the public registry of property at the location of the transferred real estate property.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

It is not mandatory to prepare a letter of intent, term sheet or memorandum of understanding pursuant to Mexican law, although company bylaws may provide otherwise. However, these preliminary documents are very helpful guides for the drafting and negotiation of transaction documents. Letters of intent or term sheets may have a non-binding section and a binding section. The non-binding section typically includes an indicative methodology or range to determine pricing and may include a description of the general transaction structure. The binding section usually includes confidentiality agreement and may include a penalty upon termination for certain listed reasons.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: A term sheet customarily includes exclusivity provisions;
- Break fee: It is not typical for a term sheet to include provisions dealing with break fees;
- Confidentiality: A term sheet customarily includes confidentiality provisions.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

It is not common to prepare separate confidentiality agreements and exclusivity agreements. The letter of intent usually includes provisions dealing with those matters.

Is there a duty or obligation to negotiate in good faith?

Parties are generally assumed to act in good faith pursuant to Mexican law. The Federal Civil Code, the Commerce Code and other legislation make several references to the assumption that parties entering into transactions do so acting in good faith and provide for consequences when parties do not act in good faith. The penalties applicable to a party acting with bad faith include, for example, the nullification of the relevant contract. Since the good faith of parties is generally assumed, a claim to receive indemnity for damages requires full evidence of the bad faith intent of the relevant party. Including a specific penalty in the purchase agreement for acting in bad faith is highly recommended because of the aforementioned evidence requirements, as well as difficulties determining and quantifying damages.

Agreeing to the acquisition agreement

Purpose price

Is a purchase price adjustment common?

Frequency/market practice: fairly common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: purchase price adjustment, working capital adjustment, NAV, earn-out adjustments, adjustments due to labor severance or liability, and pension benefit obligations are all common.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely; neither collar nor materiality thresholds are common in acquisitions involving non-listed entities.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually prepared by the target company or a third party (i.e., accounting firm or appointed independent appraiser).

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely.

Is an earn-out common?

Frequency/market practice: fairly common; there is flexibility to agree to an earn-out. However, tax consequences should be considered to the extent an earn-out is structured as a purchase price adjustment.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: fairly common; escrow agents are not that easy to find but banks may typically act as an escrow agent for cash held in escrow.

Is a break fee common?

Frequency/market practice: rarely; if used it is recommended to have a detailed and defined process to handle break fees.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common; the concept of materiality is not defined in Mexican law. Events that qualify as an MAE and express value amount thresholds should be specifically defined in the purchase agreement.

Is the MAE general or specific?

Frequency/market practice: both are seen.

Is the MAE quantified?

Frequency/market practice: rarely.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common; non-compete clauses are common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: waterfall provisions are rarely used. Provisions similar to blue pencil provisions are commonly included in the severability clause of the agreement.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: although fairly commonly used, a non-solicitation of employees might be difficult to enforce (or non-enforceable) in the event of default if the intent is to enforce a specific performance obligation. This is due to the freedom of work applicable under labor law.

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common; a non-solicitation clause for customers with a business substance justification should describe a place or relevant market applicable, including a definition of customer, and defined term applicable. The antitrust authority has some guidelines as to the limited number of years applicable for a term.

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: this is a fairly common clause but it is often heavily negotiated. A broad and detailed list of restrictions could be included. However, there is plenty of flexibility to negotiate its scope and content.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common, subject to prior execution of confidentiality agreements.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: rarely, but could be agreed.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen but not often quantified. Materiality is not defined under Mexican legislation, and may consider some threshold amounts on several representations, but could be difficult to define, particularly in those not easy to quantify.

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are more common now. They are mostly limited to actual knowledge of top management or key personnel.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common; this is an essential warranty requested to be included. However, some unsophisticated family business sellers may not be willing to compromise to give this warranty.

Is disclosure of the data room common?

Frequency/market practice: rarely; the data room itself is rarely disclosed. However, a disclosure schedule with exceptions applicable to the representations and warranties is quite common to include.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: fairly common.

Is a bring-down certificate at closing common?

Frequency/market practice: fairly common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate in all material aspects as of the date of signing and as of the closing date. However, essential representations are typically made without a materiality qualifier.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely; double materiality presents not only design issues in order to avoid redundancies, but its potential to lengthen discussions with respect to the structure of transactions during negotiations.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: a cap on indemnification liability not to exceed 100% of the purchase price is fairly common.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: a cap on indemnification liability on the entire agreement is fairly common. Certain indemnifications for tax and environmental-related liabilities rarely have their own cap that may compute as a separate additional cap to that applicable to the rest of the representations and warranties.

What are the common exceptions to the cap?

Frequency/market practice: fairly common; representations and specific areas of concern, particularly tax, environmental and labor-related matters, are common exceptions. For cross-border transactions where the target has operations abroad, product liability might be an exception.

Is a deductible or basket common?

Frequency/market practice: fairly common.

Is a de minimis common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: a general survival of 12-36 months is common. Tax, labor and environmental liabilities are usually tied to expiry of statute of limitations period (normally five years).

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: tax, labor and environmental liabilities are usually tied to the expiry of the statute of limitations period (normally five years).

Is warranty insurance common?

Frequency/market practice: rarely; warranty insurance is a new product that is being introduced in Mexico. It is rarely used (if at all) in domestic transactions.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: rarely; given the uncertainty and length of tax claims and tax refunds, they are rarely accepted for set-offs.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: rarely; set-offs against claims using insurance proceeds are rarely seen, partly because warranty insurance is rarely used.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: rarely.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: fairly common; obligations to take necessary or urgent actions to mitigate damages are common.

Is there an exclusion of consequential damages?

Frequency/market practice: exclusion of consequential damages is fairly common since they are not provided under Mexican law.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: rarely; these provisions are rarely included in domestic transactions. However, certain provisions in the Civil Code as well as certain judicial precedents provide guidance that might lead to an interpretation consistent with this type of provision.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes, parties may choose the governing law. It is normally where the buyer selects.

What is the common governing law?

Frequency/market practice: Mexico, if both seller and buyer are Mexican entities, and New York law, when the buyer is an entity formed in a jurisdiction other than Mexico or wholly-owned subsidiary of an entity formed in a jurisdiction other than Mexico.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is more common when the applicable law is not Mexican. Arbitration can take place in Mexico or outside Mexico.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: no stamp duty applies.

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: rarely; it is not common to have a separate tax covenant or indemnity. A specific tax indemnity is commonly included in the purchase agreement.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Netherlands

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

Typical legal due diligence work streams in the Netherlands include commercial contracts (e.g., customer, supplier and distribution agreements), financing agreements (e.g., bank and shareholder loans), real estate (owned and leased), employment and pension matters, IP, IT, regulatory/public law, environmental law and litigation. In a share deal (but not typically in an asset deal) corporate matters are a main focus area of the due diligence.

Compliance, in particular relating to anti-bribery, corruption, money-laundering and competition law, receives increased attention in due diligence exercises.

Legal due diligence is typically limited to a review of documents in a virtual data room, sometimes enhanced by expert interviews. For larger auction sales, it is common for a seller to provide a vendor due diligence report or a legal fact book as part of the information granted to bidders.

Issues identified in the due diligence are typically dealt with by either (i) having them rectified by the seller before signing/closing (e.g., obtaining waivers from third parties if change-of-control provisions have been identified in commercial contracts), (ii) drawing up specific indemnities regarding specific known risks identified in the course of the due diligence (e.g., environmental risks, ongoing litigation), or (iii) preparing general representations and warranties (e.g., existence and ownership of title to sold shares).

Payment

There are generally no restrictions regarding the pricing or the payment of the purchase price from a legal perspective. Most commonly (but not mandatory), the purchase price is paid in euro to the trust account of the civil-law notary in the Netherlands who will execute the deed of transfer of shares in the target company. This civil-law notary will then hold the received funds for the buyer until the moment that the deed of transfer of shares has been executed, at which point the notary will hold the funds for the account of the seller, after which the funds will be wired to the seller.

Signing/closing

Share sale

In the Netherlands, a transfer of shares is only effected when executing an official deed of transfer before a civil-law notary in the Netherlands. It is possible to include the share purchase agreement in the deed of transfer (if the agreement is very straightforward), although it is common practice to sign a separate share purchase agreement between the buyer and the seller in which the commercial arrangements between the parties are reflected.

Asset sale

Save for shares, real estate, large vessels and planes no notarial deed is required to transfer assets. Assets can be transferred by means of an asset purchase agreement, taking into account the specific transfer requirements that apply to a certain type of asset.

Approvals/registrations

Foreign investment

The Netherlands does not require investors to obtain any foreign investment permits or licenses.

Merger control

A transaction involving companies with turnover in the Netherlands can be subject to either Dutch merger control or the European Union merger control legal framework. If the turnovers of the parties involved meet the EU merger control thresholds, a transaction will fall outside the remit of Dutch merger control. Under Dutch merger control, a proposed "concentration" (i.e., a merger, acquisition of control or certain types of joint ventures) is subject to a mandatory pre-completion merger filing with the Dutch competition authority ("**ACM**") if the following cumulative thresholds are met:

(i) the undertakings concerned generated a combined worldwide turnover of at least EUR 150 million in the previous calendar year; and

(ii) at least two of the undertakings concerned each generated a turnover of at least EUR 30 million in the Netherlands in the previous calendar year.

The turnover of undertakings in the banking and insurance sectors is calculated according to specific rules. Significantly lower turnover thresholds apply to certain types of healthcare institutions.

A proposed concentration may not be implemented until four weeks after the formal notification (Phase 1). Within this four-week period (which can be extended if the ACM asks formal questions), the ACM will inform the notifying parties whether a license is required. If the ACM fails to notify the parties within this period, the proposed concentration is deemed to be approved. If the ACM decides within the four-week period that no license is required, the parties are allowed to implement the transaction.

If the ACM has reason to believe that the proposed concentration could significantly restrict effective competition in the Netherlands or a part thereof, especially as a result of the creation or strengthening of a dominant position, it may decide that a license is required (Phase 2). The parties will then need to file a separate license application. Upon closer examination of the proposed concentration, the ACM will either grant or refuse the license within 13 weeks.

The license will not be granted if the ACM concludes that the concentration would significantly restrict effective competition in the Netherlands or a part thereof.

Employment

Method of transfer under local law

Share deal

In a share purchase, all rights, duties and liabilities owed by, or to, the employees of the target company continue to be owed by, or to, the target company, also after the acquisition. As a consequence, all employees will transfer along including their terms and conditions of employment. All benefit contracts (e.g., pension, insurance, and payroll) need to be checked to see whether they remain applicable after closing or need to be renewed or replaced from closing.

Asset deal

If the asset transfer qualifies as a transfer of an undertaking within the meaning of the Dutch transfer of undertaking legislation (Sections 7:662 and further of the Dutch Civil Code), the employees of the seller's business will automatically transfer to the buyer by operation of law under their current terms and conditions of employment, but exceptions may apply to pensions and group-specific employment conditions, like equity plans, that by nature cannot be transferred to the acquiring entity.

Terminations "due to a transfer of business" are prohibited by law. Terminations for non-performance or economical reasons remain possible. If the asset transfer does not qualify as a transfer of undertaking, then the employees will only transfer with their consent.

Information/consultation requirements

A transaction may trigger information or consultation rights towards works councils or the trade unions of both the seller and the buyer. The works council consultation process will generally take a couple of weeks. This involves, in principle, a pre-signing obligation. In practice, a signing protocol or (elaborate) condition precedent is often used to cater for these obligations. Depending on the transaction structure, a notification to the SER Merger Committee and trade unions also need to be made. If there is no employee impact, these notifications are normally just a formality.

Pensions

Pension plans and the transfer of any past pension liabilities need to be considered carefully in the transaction context as defined benefit schemes are still quite common in the Netherlands. It also needs to be assessed if the pension plan can be continued from closing or that the employees need to go to a new pension provider as of closing. Such transfer will take time and bring along certain risks that need to be covered in the transaction documentation.

Tax

Share deal

For a buyer, the acquired shares are carried in the books at cost price. Acquisition costs are generally added to the fiscal cost price of the shares since the acquisition costs relating to the purchase of shares that qualify for the participation exemption are not tax-deductible.

For a seller, a capital gain realized on the sale of shares in a subsidiary that qualifies for the Dutch participation exemption regime is exempted from Dutch CIT. A shareholding in a subsidiary generally qualifies for the participation exemption regime if the shareholding represents 5% or more of the nominal issued paid-up capital of the subsidiary, unless the subsidiary is (deemed to be) held as a passive investment and its assets comprise 50% or more of low-taxed portfolio assets (e.g., group loans, IP passively licensed within the group).

For VAT purposes, transactions relating to shares and participations in other companies (e.g., acquisition, holding and sale of shares) only fall within the scope of VAT when certain conditions are met. If the acquisition of shares falls within the scope of VAT, the input VAT incurred may be deducted in accordance with the general rules (i.e., the pro-rata calculation method). If the sale of shares falls within the scope of VAT, then it is, in principle, regarded as a VAT-exempt transaction. However, the deductibility of input VAT on costs in relation to the acquisition and sale of shares very much depends on the facts of each individual case. The proposed set-up of a share deal should be carefully reviewed to mitigate the risk of non-recoverable VAT.

The acquisition of shares in a company may be subject to real estate transfer tax ("**RETT**") if the assets of the company consist 50% or more of real estate assets and 30% or more of Dutch real estate, and these assets are held with the purpose to exploit the real estate as such.

Asset deal

For a buyer, the basis for the amortization of the acquired assets is the acquisition price minus the residual value. Acquired goodwill can be amortized at a maximum rate of 10% per year. Other business assets can be depreciated at a maximum rate of 20% per year. Depreciation on buildings is subject to specific rules.

For a seller, the capital gain realized is typically subject to Dutch CIT at a rate of 25%.

Under certain conditions, a seller is allowed to temporarily defer taxation of the capital gain if the seller intends to reinvest in another business asset. Furthermore, any remaining tax losses remain with seller.

For VAT purposes, the transfer of assets can either qualify as several distinct supplies of goods and services (where each of which is subject to VAT at the appropriate rate) or as the transfer of a business as a going concern ("**TOGC**").

Whether or not a TOGC applies depends on whether specific conditions are met. A TOGC applies by law and is not optional. In the case of a TOGC, no VAT is due on the transaction. Under the TOGC regime, input VAT incurred on costs of the transaction may be deducted in accordance with the general rules for general costs (i.e., the pro-rata calculation method). Deductibility of VAT on costs and assets in the case of a non-TOGC asset transfer should be assessed individually.

In general, RETT is levied upon the transfer of Dutch real property. Under certain conditions, transfer tax exemptions may apply.

Post-acquisition integration

Usually, the shape of the structure of the group is taken into consideration before initiating an acquisition. It is therefore quite common to prepare a rough outline of the post-acquisition integration procedure before the transaction has been completed and to subsequently initiate the post-acquisition integration within a couple of months after closing. It is important to note that tax and employment considerations are usually the main drivers behind the final shape of the structure, and the presence of employees in the group can delay the finalization of the integration process. Finally, it should be noted that the full suite of Dutch corporate reorganization tools, being mergers, splits, conversions and transfers, are available to perform the integration.

Common deal structures

What are the key private M&A deal structures?

In the Netherlands, typical deal structures in private M&A are bilateral or (controlled) auction processes for the acquisition and disposal of shares in the share capital of private companies.

Auction processes are fairly common in the Netherlands, mostly seen in regulated markets or capital-intensive industries, such as energy, IT/telecom and healthcare.

Both indicative bid letters and non-binding offers are being used in auction processes, although final bid offers are seen more often, mostly accompanied by a request for a mark-up of a share purchase agreement after signing a non-disclosure agreement ("**NDA**") and the performance of a limited due diligence investigation by prospective buyers.

Dutch insolvency law currently does not provide for a scheme of arrangement procedure for the restructuring of debts outside of bankruptcy. The company or creditors may informally offer a composition to creditors and/or shareholders, but they are free to decide whether to cooperate and are not bound by a composition in insolvency.

In May 2020, the House of Representatives (*Tweede Kamer*) passed a bill for an amendment to the Dutch Bankruptcy Act, referred to as the 'court confirmation of extrajudicial restructuring plans to prevent bankruptcy act' (*Wet homologatie onderhands akkoord ter voorkoming van faillissement* (WHOA)) or CERP. The CERP is inspired by the scheme of arrangement procedure in the US and UK and should enable companies in financial difficulties to offer a compulsory composition to its creditors outside of bankruptcy. The composition can be initiated by the company or creditors (an expert may be appointed through the court) and offered to co-creditors and shareholders, which could lead to amendments of their (contractual) rights and positions. If the composition is supported by a majority of creditors and/or shareholders, the company can request the court to approve and declare the composition generally binding for all creditors and shareholders, unless the interest of certain creditors will be unreasonably damaged. The CERP bill is currently under review by the Dutch Senate (*Eerste Kamer*) where it can be adopted or rejected in its entirety. It is expected that the bill will be discussed in or before autumn 2020.

Apart from share and asset transactions, which are not mergers in the strict sense of the word, Dutch law permits legal mergers of companies, whereby all the assets and liabilities of one or more companies are acquired and assumed, respectively, by an existing company or by a new company formed for the purpose, while the company or companies whose assets and liabilities have thus been acquired or assumed cease to exist by operation of law. The shareholders of the disappearing company become shareholders of the acquiring company.

The merger procedure is used primarily for inter-group reorganizations. Only rarely is this procedure used as a means of acquiring the shares in an unrelated party. At present, legal mergers apply to Dutch companies and SEs and, under certain circumstances (as a consequence of recent (EU) case law (Sevic Systems: ECJ case C-411/03 (2003))), mergers involving a Dutch and a foreign company.

A demerger is a legal act whereby either:

- all the assets and liabilities of a company (which ceases to exist) are acquired and assumed respectively by two or more companies; or

- all or part of the assets and liabilities of a company that remains in existence are acquired and assumed respectively by one or more other companies, of which at least one issues shares to the shareholders of the demerging company or of which at least one is incorporated by the demerging company.

Share deals whereby a purchaser acquires the shares of a company from a seller are by far most popular in the Dutch market. However, all types of transaction (share and asset deals or legal mergers) are seen in the Dutch private M&A market. The specific structuring of these transactions is largely tax driven.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

Private limited liability companies in the Netherlands are known as *besloten vennootschap* or BV.

What are the different types of limited liability companies?

Dutch law distinguishes between two types of limited liability companies: public limited liability companies (*naamloze vennootschap* or NV) and private limited liability companies (*besloten vennootschap* or BV). An N.V. can issue (depositary receipts of): (i) registered shares, or (ii) bearer shares. A BV can only issue (depositary receipts of) registered shares, a significant feature illustrating its private character. On the other hand, a BV is exempt from some of the formal requirements of an NV. For instance, a BV does not require a minimal level of share capital to register or commence trading.

Is there a restriction on shareholder numbers?

There are no restrictions on shareholder numbers.

What are the key features of a share sale and purchase?

The transfer of shares in a BV or NV requires the execution of a notarial deed before a Dutch civil law notary in the Netherlands. This obligation does not apply to NVs whose shares or share certificates are in bearer form or are officially listed on a regulated stock exchange.

What are the key features of an asset sale and purchase?

Asset transactions are normally used either for tax reasons (e.g., to minimize the risk of undisclosed or contingent liabilities of the target company) or to sell only a portion of a company's business.

Asset transactions tend to be much more complicated since each category of asset has to be transferred separately in accordance with applicable legal transfer requirements. In an asset sale, contracts with suppliers, customers and other contractual counterparties of the acquired business need to be transferred, so the co-operation or consent of those parties must be obtained (remembering that ultimately the parties can refuse to deal with a purchaser and instead terminate the agreement). This means that in asset sales, there is a risk that government or other approvals, licenses and permits held by the business may be lost.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

It is customary to enter into letters of intent (term sheets, heads of terms or any document in which the preliminary understanding of parties is laid down) during or before the negotiation phase of share or asset transactions. Letters of intent are subject to the ordinary principles of Dutch contract law and can be considered to be legally binding on all parties. However, the extent to which the parties are bound strongly depends on the specific wording or content, all circumstances during the preparation, negotiation and signing of the letter of intent, the parties' intentions and their conduct. On the basis of Dutch case law, a key factor for the court in determining whether a letter of intent is legally binding is whether parties have reached an agreement on the key terms of the intended transaction.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: It is customary that a term sheet includes exclusivity provisions on the basis of which the prospective buyer is given a limited period for negotiations with the seller in order to reach a definitive agreement for the transaction.
- Break fee: Break fees are not common provisions in term sheets for private acquisitions in the Netherlands. However, penalties can be incurred for breaches of exclusivity or confidentiality provisions.
- Confidentiality: It is customary to include provisions on confidentiality in a term sheet related to the transaction, the parties and affiliates involved, the term sheet itself and all other documents and information that need to be exchanged between parties in light of the transaction.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Specific provisions in a term sheet, such as exclusivity and confidentiality, are commonly separately negotiated with the preferred bidder. Confidentiality agreements are often separately negotiated and, although less so, exclusivity agreements.

Is there a duty or obligation to negotiate in good faith?

Special care must be given to the principles of pre-contractual good faith under Dutch law. These principles may, under certain circumstances, mean that a party may not terminate ongoing negotiations without being liable for damages to the other involved negotiating party or parties or even (in extreme cases only) lost profits. Whether such liability will arise in a particular case will depend on all relevant facts and circumstances of the matter at hand. These circumstances include (but are not limited to) the conduct of all parties involved, their reasonable expectations and their level of professionalism (including that of their advisors). As most parties wish to eliminate any uncertainties upfront, they often opt to sign a pre-acquisition agreement, such as a letter of intent, to govern the rights and obligations during the negotiations phase. Usually, such an agreement will include specific provisions stipulating that parties are entitled to terminate the negotiations at any stage until a definitive agreement governing the transaction has been executed.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: very common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: cash free/debt free is very common. Working capital is fairly common. NAV is rarely seen.

Is there a collar on the purchase price adjustment?

Frequency/market practice: collars are hardly ever used.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: in a seller's market, this is usually prepared by the seller; in a buyer's market, it is usually prepared by the buyer.

Is the balance sheet audited (where applicable)?

Frequency/market practice: fairly common; very much depending on the size of the transaction and the balance sheet date. It is fairly common in large transactions, but rare or not at all in small transactions.

Is an earn-out common?

Frequency/market practice: fairly common; more common in transactions where the sellers continue to manage the target company after closing. They are less common where the seller is completely exiting. Earn-outs are used sometimes to bridge the valuation gap.

Is a deposit common?

Frequency/market practice: rarely; yes for the purpose of securing both purchase price adjustment and indemnification obligations of the seller under representations and warranties.

Is an escrow common?

Frequency/market practice: very common.

Is a break fee common?

Frequency/market practice: rarely. In light of the Corona COVID-19 crisis, parties should pay attention to what has been agreed upon in the pre-signing stage of the M&A transaction. Specific arrangements can be agreed upon e.g., with respect to purchase price adjustment mechanisms as a consequence of the impact on the target's financial position and operations due to pandemics such as the COVID-19 outbreak. Standard Dutch legal concepts may not provide sufficient relief to such circumstances. The Dutch court in preliminary proceedings of the NCC (Netherlands Commercial Court) has recently (29 April 2020) ruled that the COVID-19 crisis does not give rise to any reductions or changes to a 30 million break fee agreed between parties in an LOI in the event of failure to sign a transaction agreement (ECLI:NL:RBAMS:2020:2406). Although the COVID-19 crisis can be qualified as an unforeseen circumstance (*onvoorziene omstandigheid*), the court has considered that the objective of the break fee is to encourage parties to enter into the transaction and to split risks between them, which objective would be frustrated if the fee could be reduced in the event of decrease of the value of the target company - as a quick way out for the payment obligation of the purchase price of EUR 169 million. For example, unforeseen circumstances can only result in adjustments to an agreement if it is considered absolutely unreasonable for one of the parties in relation to the other party.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: rarely, although it is expected that discussions and special attention will be paid to MEA provisions to cover for epidemic, pandemic or diseases since following the COVID-19 outbreak (see also comment above under "break fee").

Is the MAE general or specific?

Frequency/market practice: both are seen.

Is the MAE quantified?

Frequency/market practice: fairly common; sometimes seen as a reference to sales or EBITDA.

Covenants

Is a non-compete common?

Frequency/market practice: very common; more common in certain sectors and if sellers are individuals.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: rarely; waterfall provisions are uncommon.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: very common; carve-out for hiring on the basis of general advertisements (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common (in conjunction with a non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common; referred to as pre-completion covenants. These may conflict with competition laws.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; generally get this for private deals. There are competition law issues around potential 'gun-jumping.'

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: very common; by separate agreement referred to as a disclosure letter. Notification of possible breach is seen. However, this usually has no effect on the right to terminate the agreement unless MAE.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen but are often not quantified (other than specific warranties, e.g., contract, litigation value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: this is often limited to actual knowledge and knowledge after due enquiry of a specified list of senior management.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common; heavily negotiated and qualified by buyer having conducted proper due diligence.

Is disclosure of the data room common?

Frequency/market practice: very common; almost universal.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: very common; repetition at completion is common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: rarely; it is not common to repeat warranties "at all times", however, it is very common to repeat warranties at closing.

Is a bring-down certificate at closing common?

Frequency/market practice: rarely; however, it is common to provide disclosure letters in which updates of the data room are reflected.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate in all material respects is common but often carve out for fundamental representations which must be absolutely true.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: fairly common.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: very common; the common cap amount is typically between 15%-30%. Title to shares is almost always capped at the amount of the purchase price.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: very common; maximum liability cap applies to all of the seller's obligations under the agreement. Other than in relation to warranties, de minimis thresholds and basket liability caps do not apply.

What are the common exceptions to the cap?

Frequency/market practice: often, tax liability, confidentiality and non-compete undertakings or specific indemnities are excepted. Liability under these undertakings is often not capped or made subject to a specific regime (sometimes with specific higher caps).

Is a deductible or basket common?

Frequency/market practice: very common; deductible is usually resisted. A tipping basket is more common.

Is a de minimis common?

Frequency/market practice: very common.

How long does seller liability survive?

Frequency/market practice: a general survival of 18–24 months is common.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: it is common to carve out key warranties (e.g., title, capitalization, authority, tax, employment and environmental) as well as fraud.

Is warranty insurance common?

Frequency/market practice: fairly common; becoming increasingly popular, most notably in auctions and PE

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: required by law.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: rarely; often silent.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: it is common to have Dutch law if the target is in the Netherlands.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: 50/50.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: there is no stamp duty. Notarization fees for the transfer of shares in a limited liability company are paid by the buyer.

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: very common; almost universal.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Peru

Quick reference guide

Due diligence, pricing and closing

Due diligence

In Peru, environmental and regulatory non-compliance is not uncommon in a wide variety of industries, particularly where the target is a family-owned business. Sanctions for non-compliance range from fines to corrective measures, such as the seizure of goods, closure of the company or establishment in breach, as well as demolition of infrastructure (uncommon).

Labor and tax matters are key matters to be reviewed as part of a due diligence process. Sanctions for non-compliance in both cases include the claw-back of the unpaid amounts plus interest and fines for all periods within the statute of limitations (generally, six years for tax and five years after termination of the labor relationship for labor).

A thorough due diligence process focusing on these issues will help identify material breaches and assess the exposure of the target, taking into consideration typical enforcement and detection rates. It will also enable the parties to consider what remedies or actions are needed prior to signing, between signing and closing, and post-closing.

Pricing and payment

There are no special restrictions regarding pricing and payment in Peru from a strictly legal/corporate point of view. However, for tax purposes, certain considerations should be taken into account:

- Transfers of shares and assets are taxed at fair market value, determined according to the arm's-length principle, regardless of the contract price agreed. Transfer pricing rules are applicable to related party transactions. In share transfers (including nonrelated party transactions), if the price per share agreed by the parties is lower than the *valor patrimonial* (i.e. total net equity value divided by capital stock of the issuing company) of each such share, the tax authority shall deem the price per share to be the *valor patrimonial* for the calculation of the applicable capital gain tax.
- In order to be entitled to deduct a cost for tax purposes, foreign investors selling shares or assets in Peru must obtain a "Recovery of Invested Capital Certificate" from the SUNAT (the Peruvian tax authority) before receiving the purchase price. The document must certify the cost to be deducted and any payment received in the absence of this certificate would determine that no cost could be deducted for the calculation of the applicable capital gain tax. The Recovery of Invested Capital Certificate may be obtained within 30 business days and remains valid for 45 calendar days following its issuance.
- In order for a buyer to have the right to deduct the amount paid for the shares as a cost in a future share sale, the purchase price must be paid through a Peruvian bank account or another authorized means of payment, such as drafts or wire transfers from a foreign bank or financial entities, provided that payments are channelled through or into an account in a Peruvian financial institution. Likewise, if the seller is a domiciled corporate taxpayer, shares would have to be invoiced.
- In assets transfers, it is necessary for tax reasons to itemize each transferring assets in the invoice issued by the seller.

Foreign exchange control

Peru has a floating exchange regime that operates as part of a wider inflation-targeting economic policy implemented by the Peruvian Central Reserve Bank, which monitors currency flows and purchases foreign currency to ensure stability. In general, the Central Bank does not restrict the free-flowing exchange market. There are no restrictions on the currency of payment for goods or services, although local trade is usually carried out in local currency, the Peruvian sol. Foreign investors are therefore not legally required to exchange foreign currency into Peruvian soles. US dollar accounts are widely used in the banking system and euro deposits are available in certain entities. The purchase price in a share or asset deal is usually expressed in Peruvian soles or US dollars.

While currency can be exchanged freely, the Superintendence of Banking and Insurance publishes an average exchange rate that is applicable for official purposes, such as tax calculations.

Signing/closing

A deposit is not required, nor is it common, in Peru. Sometimes, a part of the purchase price is withheld to incentivize post-signing/post-closing compliance. The purchase price may be subject to other enforcement mechanisms, such as an escrow account or a guarantee trust.

Whether signing and closing is simultaneous or non-simultaneous will depend on the conditions and complexity of each transaction. Both mechanisms are common.

Approvals/registrations

Foreign investment

Subject to constitutional guarantees and foreign investment regulations, foreign investment will receive the same treatment as an investment made by Peruvian nationals. In certain cases, such as where there is a prior contract with the government to be entered into upon satisfaction of certain conditions, the investment may be granted special protection through what is known as a "legal stability agreement." Legal stability agreements are civil contracts that protect investors (and the local companies that receive their investment) from changes in certain laws and regulations in effect when the investment was initially registered. Legal stability agreements typically guarantee certain tax and labor conditions, as well as rules regarding the remittance of profits. If the regulations change going forward, such new rules cannot be enforced against the company or the investors.

Note that where a Peruvian company or foreign investor enters into a legal stability agreement, any corporate reorganizations or transfers of shares owned by the registered investor must be previously authorized by Pro-Inversion to allow the protections afforded by the legal stability agreement to be transferred to the new investor and maintained by the company that received the investment. Otherwise, the legal stability agreements will be terminated.

Legal stability agreements are also available for local and foreign investors in mining projects. As with the general stability agreements, mining stability agreements protect investors from changes in certain laws and regulations for a term that varies between 10 and 15 years, starting on the date the investment is made or increased.

To obtain a legal stability agreement with the Peruvian government, investors are required to guarantee an investment of no less than USD 5 million, except in the case of the mining and hydrocarbon sectors, in which the minimum investment is USD 10 million, within two years following the execution of the legal stability agreement. Investments made twelve months prior to the legal stability agreement can also be credited as part of the investment commitments under such agreement. Note that the requirement is that new money is invested in the recipient company. Therefore, the purchase price paid to acquire the shares of the target does not qualify for these purposes. The investment shall be made with a capital injection to the recipient company in exchange for new shares issued to the investor. The investment shall be deposited in a Peruvian bank account.

The sole restriction on foreign investors prescribed by the constitution is that they cannot acquire or possess certain assets within 50 kilometers of the border unless an exception based on public necessity or the national interest is declared by Supreme Decree. Prohibited assets include mines, lands, forests, water, and fuel and other energy sources.

In addition, certain strategic sectors are subject to foreign ownership restrictions. For example, commercial aviation activities are restricted to Peruvian nationals and companies. A company is considered Peruvian when at least 51% of its capital stock is effectively held and controlled by Peruvian nationals. This ownership ratio may be reduced to 30% six months after authorization is granted by the competent authorities. Similar rules apply to land and marine transportation as well as to radio and television broadcasting services, where there are certain limitations (but not a complete prohibition) on ownership by foreign investors.

Merger control

As of June 2020, as a general rule, M&A deals are not subject to authorization by the free competition authority in Peru ("**INDECOPI**"). The sole exception is the power sector (generation, transmission and distribution), where approval by INDECOPI is required when certain thresholds are reached.

However, a new merger control law that shall apply to all sectors and abrogate the current law shall come into effect on March 1, 2021 (*please refer to "Antitrust" for further detail*).

Other regulatory or government approvals

The rules vary depending on the specific sector or industry. Sector regulators may prescribe specific approvals and conditions for incorporation of, or the acquisition/increase of shares in, a company. For example, approval by the Superintendence of Banking and Insurance is required for certain acquisitions in companies in the financial and insurance system. These regulations are applied equally to foreign and domestic investors.

Employment

Share sales: When a business is transferred through a stock purchase, this transaction will not involve a change of employer. Therefore, employee conditions, benefits and entitlements are unaffected. Notice to and consent from employees are not required for the transfer.

Corporate reorganizations: If the transaction is structured involving a corporate reorganization (merger or spin-off) that entails the transfer of personnel, it would be considered an employer substitution if the parties have not previously assigned or terminated their employment agreements. This would operate automatically, by virtue of law, upon execution of the reorganization and no prior consent by employees is required.

Corporate reorganizations (hive down): In the specific case of hive downs, the transfer of personnel is not automatically triggered by law. As a consequence, it is highly recommended to obtain the express consent of employees in order to transfer them. Employees can be transferred via a tripartite agreement between the employee, the employer and the new company or a termination-and-rehiring by the new company.

Employees are legally entitled to refuse the transfer and it will not be considered a termination clause. There is no mandatory notice period.

Asset sales: If the transaction is structured as an asset purchase that entails the transfer of personnel, consent from employees must be obtained to allow their transfer. Employees can be transferred via a tripartite agreement between the employee, the employer and the new company or a termination-and-rehiring by the new company that is acquiring the assets of the business. Employees are legally entitled to refuse the transfer and it will not be considered a termination clause.

Tax

No stamp duty applies. For foreign investors, capital gains tax is applicable to the direct or indirect transfer of shares issued by a Peruvian company. The general applicable tax rate is 30%. However, a preferential rate of 5% for direct transfer of shares via the stock exchange applies subject to the fulfilment of certain conditions.

VAT is not applicable in a share transfer, but it does apply to asset deals and is calculated at a rate of 18%. If the seller is a corporate taxpayer, both assets and shares would have to be invoiced. However, VAT will apply only in the case of the assets. Under an asset deal transaction, the VAT taxpayer is the seller; however, the buyer bears the economic burden of the VAT. The VAT paid in the purchase of the assets qualifies as a VAT credit for the buyer.

Post-acquisition integration

N/A

Common deal structures

What are the key private M&A deal structures?

Key deal structures for private M&A transactions are the acquisition of shares or assets, investments involving majority or minority stakes, and corporate reorganizations (e.g., merger, spin-off and simple reorganization).

The acquisition of shares or assets is usually undertaken by a negotiated acquisition. The private share or asset purchase agreement is drafted setting out the terms and conditions of the acquisition, as well as the representations, warranties, covenants and liabilities of the parties.

It is also common to see the acquisition carried out by means of an investment in the target company by the investor. As a consequence of the investment, the target company's capital stock will be increased, new shares will be issued in favor of the investor and the percentage of participation in the target company of the other shareholders will be reduced.

A merger occurs where two or more companies consolidate as one single entity. A merger can be conducted in either of the following ways:

- merger of two or more companies to create a new independent and separately incorporated company (and where the two merging companies cease to exist); or
- one company takes over the entire business of the other company so that the target company ceases to exist.

In both cases, the new entity or the remaining company receives all of the assets, liabilities, rights and debts of the companies that cease to exist, and the shareholders of the companies ceasing to exist receive outstanding shares in the new or remaining company.

A spin-off is a type of corporate reorganization that consists of the segregation of assets, debts-and-assets and/or business lines by a company to transfer them to another company, which may be already incorporated or may be incorporated as a result of the contribution of that block of assets, debts-and-assets and/or business lines. In either case, the shares to be issued by the company receiving the segregated block under that equity contribution must be issued to the shareholders of the company transferring the block. Spin-offs may also be used to segregate business lines or activities and assigning them to specific shareholders, instead of pro-rata the original distribution.

A simple reorganization is the segregation of assets, debts-and-assets and/or business lines in order to transfer them to another company. The company that receives the assets, debts-and-assets and/or business lines must issue new shares (if applicable) for the contributing company.

Auction processes are frequently seen in Peru for medium to large transactions. Small transactions are usually conducted through bilateral negotiations.

Negotiation usually includes, from the seller's side, the delivery of a 'teaser' to potential buyers. This is followed by the execution of a non-disclosure agreement. Commonly, the next steps, for the seller, are to deliver a process letter to potential buyers and to negotiate a non-binding bid or term sheet (i.e., a list of relevant terms with their corresponding definitions and conditions) with them.

In some limited cases, authorizations or permits must be obtained prior to closing M&A transactions (*please refer to Approvals/Registrations above*).

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

The General Corporations Law contemplates the different types of corporate vehicles investors may use to carry out economic activities in Peru. The most common entities are:

- corporations (under their regular form or as closely held corporations) (*Sociedad Anónima* — SA and *Sociedad Anónima Cerrada* — SAC);
- limited liability companies (*Sociedad Comercial de Responsabilidad Limitada* — SRL); and
- branches (*Sucursales*).

The first two options are usually used by investors wishing to incorporate a subsidiary in Peru and provide limited liability for shareholders or partners. The branch is used as an extension of a parent company and the parent will ultimately be responsible for obligations incurred by the branch.

As of September 2018, the simplified closely held corporation (*Sociedad por Acciones Cerrada Simplificada* — SACS) has been created and will soon be made available to investors who are individuals.

What are the different types of limited liability companies?

Limited liability companies resemble closely held corporations. Both types of entities require a minimum of two and allow a maximum of 20 shareholders. Limited liability companies, however, do not issue shares (the capital is represented by quotas) or have a board of directors. Although closely held corporations typically do have a board, it is not compulsory. The procedures for incorporating are the same as for a corporation (SA).

The law does not establish a minimum amount of capital to incorporate a company, although some industries establish some minimum requirements and limit the corporate forms that can be used (e.g. banking and insurance sectors allow only corporations). The initial cash contribution for incorporation must be deposited in a local bank (contributions in kind are also permitted but are subject to particular rules).

Shares may not be issued in limited liability companies, as the capital is divided into participation quotas. Certain limitations may apply to transfers of these participation quotas, such as a right of first refusal in favor of the partners of the company and the company itself. In addition, to be valid and effective, any transfer of participation quotas must be formalized in a public deed and registered in the Public Registry.

The recently added form of a "simplified closely held corporation" is, to some extent, similar to limited liability companies and traditional corporations, but reduces certain formalities and terms associated with incorporation and administration at the expense of providing less flexibility. For example, shareholders may only be individuals.

Is there a restriction on shareholder numbers?

There is a minimum of two and a maximum of 20 quotaholders (in the limited liability companies) or shareholders (in the closely held corporation). The corporation (under its regular form) has a minimum of two and a maximum of 750 shareholders.

What are the key features of a share sale and purchase?

The acquisition of shares is mostly undertaken by privately negotiated acquisition. The most common provisions found in a share purchase agreement relate to representations and warranties, covenants and indemnification clauses.

It is quite common to also see buyer protection clauses, which usually take the form of a negotiated warranty and indemnity coverage from the seller. The terms of the protection will vary from transaction to transaction, but it is quite standard to expect that limits will be negotiated on any such terms protecting the seller, including claim thresholds and caps, time limits and adjustments for items disclosed or accounted for. Other types of guarantee (e.g., placing funds in escrow or guarantee trust, holding back part of the purchase price and security interests) are also common.

What are the key features of an asset sale and purchase?

An acquisition of assets is conducted by a private negotiated acquisition by means of an asset purchase agreement. According to the General Corporations Law, if the assets to be sold by the seller represent more than 50% of its capital, a shareholders' meeting approving the transfer of assets is required.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

It is common to prepare a letter of intent or term sheet in bilateral negotiations. A letter of intent or term sheet usually includes the most relevant conditions of the acquisition (i.e., price, price adjustments, object of the transaction, due diligence, means of payment, shareholder agreement provisions, etc.). Commonly, only certain terms therein shall be binding on both parties (e.g. confidentiality, exclusivity, governing law and dispute resolution). Most terms (e.g. structure, purchase price, representations and warranties, condition precedents, indemnification) will be non-binding on the parties.

A letter of intent or term sheet is uncommon in auction sales.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: A term sheet commonly includes provisions on exclusivity.
- Break fee: A term sheet does not customarily include provisions on break fees.
- Confidentiality: A term sheet commonly includes provisions on confidentiality.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

It is not common to negotiate separate agreements for exclusivity or break fee. Confidentially provisions are commonly negotiated under a stand-alone non-disclosure agreement.

Is there a duty or obligation to negotiate in good faith?

A civil action claiming pre-contract damages may be pursued by an injured party if the negotiations are terminated in breach of good faith obligations by another party, but the existence and amount of the alleged damage must be proven by the claimant.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: purchase price adjustments are very common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: cash free/debt free is very common. Working capital is fairly common. Net Asset Value (NAV) is rarely seen.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely; neither collar nor materiality thresholds are common.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually prepared at closing by the target company or the seller. After closing, it is usually reviewed by the buyer or an audit company.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely; historical balance sheets for completed fiscal years are often audited. Interim balance sheets are typically unaudited.

Is an earn-out common?

Frequency/market practice: rarely; although they are occasionally agreed.

Is a deposit common?

Frequency/market practice: rarely; but it could be agreed.

Is an escrow common?

Frequency/market practice: fairly common.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common.

Is the MAE general or specific?

Frequency/market practice: the MAE definition is usually general and forward-looking, but sometimes includes specific carve-outs.

Is the MAE quantified?

Frequency/market practice: rarely; relatively uncommon.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: waterfall provisions are rarely used. Blue pencil provisions are commonly included in severability clause of agreement. The need for a non-compete provision shall be assessed on a case-by-case basis and generally agreed as an ancillary provision.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: they are fairly common for a 2-3-year term (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: they are fairly common for a 2-3-year term (in conjunction with a non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: fairly common; restrictions on the seller in relation to the conduct of the target's business in the period between signing and closing are fairly common, especially when time-to-closing is substantial due to regulatory or third-party consents to be obtained as a condition precedent to closing.

Common restrictions include no disposal of assets, restrictions on entering into financial debt or material agreements, operations to be carried out in the ordinary course of business consistent with past practices, no changes to CAPEX or collection of accounts.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; this is subject to the prior execution of confidentiality agreements.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: fairly common; updating schedules is common; notification of possible breach is not common. Accuracy of warranties at closing is a common condition precedent.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen but are not often quantified (other than specific warranties, e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are usually based on constructive knowledge (after due inquiry), although actual knowledge standard is also used. They are commonly limited to a list of specified persons or group of persons (selling shareholders and key managers and directors).

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: common.

Is disclosure of the data room common?

Frequency/market practice: fairly common; this is common if the seller has a strong bargaining position.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: repetition at signing date and closing date is fairly common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: it is rare to repeat warranties at all times between signing and closing.

Is a bring-down certificate at closing common?

Frequency/market practice: bring-down certificates at closing are fairly common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: both accurate 'in all material respects' standard and MAE standard are common. Often, carve-outs for some fundamental representations are common, which must be absolutely 'clean and true.'

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely; double materiality is usually avoided.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: it depends on the size and type of transaction; usually ranges from 5%-30%.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: caps commonly apply to indemnification obligations in the whole agreement (although breaches of seller's/target's covenants are often carved out from the cap). Other limitations on liabilities (such as baskets and mini-baskets) commonly apply only to the representations and warranties. Specific representations and warranties or other items in the agreement may have different cap amounts.

What are the common exceptions to the cap?

Frequency/market practice: fraud is usually excluded from the cap. Certain fundamental representations and warranties (e.g., authority, capitalization, due organization and title) are also commonly excluded. Breaches of seller's/target company's covenants are also often carved out from the cap. Recently, anticorruption representations and warranties have been heavily negotiated to be excluded.

Is a deductible or basket common?

Frequency/market practice: baskets are fairly common. True deductibles are seen if the seller has a strong bargaining position.

Is a de minimis common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: typically 18-36 months.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: common carve-outs include: taxes, labor, capitalization, due authorization and organization, ownership of shares and fraud — usually tied to the expiry of statute of limitations.

Is warranty insurance common?

Frequency/market practice: rarely.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: fairly common.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: we commonly see 'pro-sandbagging' provisions. It is less common to see 'anti-sandbagging' provisions - seller must have a strong bargaining position.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes, parties may choose the governing law.

What is the common governing law?

Frequency/market practice: Peruvian law is agreed in most transactions, although New York law is sometimes seen in very large deals.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is more common, usually in the Lima Chamber of Commerce or American Chamber of Commerce of Peru.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: no stamp duty applies.

Is a separate tax covenant / indemnity or tax deed common?

Frequency/market practice: it is fairly common to have a specific tax covenant/indemnity included in the purchase agreement.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Philippines

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

Regulatory non-compliance is a common issue in the Philippines and this can mean additional costs for rectification and operations post-closing. In highly regulated industries e.g., healthcare and telecommunications, regulatory non-compliance issues are prevalent, particularly in locally owned target companies (as opposed to target companies that are owned by large multinational companies).

Requiring the seller to attend to housekeeping matters before closing is common. Seeking protection via a reduction in the purchase price or a holdback of the purchase price, with either party completing clean-up measures after closing, may also be considered.

Pricing and payment

Foreign exchange control

Generally, no foreign exchange control regulations or approvals are required in a share sale. However, if the seller has not registered its investment in the target company with the central bank, Bangko Sentral ng Pilipinas ("**BSP**"), the buyer will generally not be able to obtain such BSP registration for its acquisition of shares in the target company.

BSP registration is not mandatory but it will be needed if the buyer would like to purchase foreign exchange from the domestic banking system to fund the repatriation of capital and remittance of dividends.

If the foreign investment is not registered with the BSP, the buyer may legally purchase foreign exchange outside the banking system.

In the case of an asset sale, the buyer that registers an acquiring entity with the SEC may choose to obtain BSP registration for its investment in the acquiring entity.

Signing/closing considerations

Is a deposit required?

A deposit is not commonly seen in share sales and asset sales.

Is simultaneous signing/closing common?

It is common for there to be a gap between signing and closing, as closing is often subject to the condition that all government approvals, and non-regulatory consents and approvals have been obtained.

Share sale

The transfer of the shares from the seller to the buyer is only recorded in the stock and transfer book of the target company after the tax clearance process for the share sale is completed.

Asset sale

An asset sale will generally require the buyer to establish a local subsidiary or branch office and this may have an impact on the timing of the closing of the transaction, unless the buyer has an existing subsidiary or branch that can act as the acquiring entity.

Approvals/registrations

Foreign investment restrictions

Foreign investors may own up to 100% of a domestic enterprise in the Philippines if the domestic enterprise is not engaged in any of the activities listed in the "negative list" of the Foreign Investments Act ("**FIA**").

Under the FIA, a domestic market enterprise that is more than 40% foreign-owned must have a paid-in or assigned capital of the Philippine peso equivalent of at least USD 200,000. This amount may be reduced to USD 100,000 if the activity of the domestic market enterprise involves advanced technology as determined by the Department of Science and Technology, or if it employs at least 50 direct employees as determined by the appropriate regional office of the Department of Labor and Employment.

An export enterprise is not required to comply with this minimum capitalization requirement. An export enterprise is a manufacturer, processor or service entity that exports 60% or more of its output, or a trader that purchases products domestically and exports 60% or more of such purchases.

A buyer must determine whether foreign equity restrictions apply to the target company or the business. If such restrictions apply, the buyer may need to establish a joint venture with a Philippine partner to comply with foreign equity restrictions.

Foreign investment approvals

Share sale

If the acquisition results in foreign equity in the target company exceeding 40%, it must register under the FIA. An FIA-registered corporation is required to re-register under the FIA in case of further increases in its foreign equity pursuant to, among other things, an additional subscription to its shares of stock.

Asset sale

The buyer must establish and register a Philippine subsidiary or a branch office of a foreign corporation and comply with the foreign investment restrictions discussed above, in addition to any minimum paid-up capital requirements under the FIA and other applicable laws.

Other regulatory or government approvals

Most M&As in the Philippines do not require special statutory or regulatory approval unless the target company operates within certain regulated industries, such as banking, insurance and telecommunications, or is subject to special registrations.

A statutory merger, which involves the transfer of assets, requires approval from the SEC.

If an asset sale involves the sale of all, or substantially all, of the assets of the seller, the sale will need to be approved by the board of directors and stockholders representing at least two-thirds of the outstanding capital stock, and the seller must comply with the Philippine Bulk Sales Law ("**Bulk Sales Law**").

Merger control (antitrust/competition approval)

Under the Philippine Competition Act ("**PCA**") or Republic Act No. 10667 and its Implementing Rules and Regulations ("**PCA-IRR**"), an M&A transaction must be notified to the Philippine Competition Commission ("**PCC**") when the following conditions are met:

- the aggregate annual gross revenues in, into or from the Philippines or the value of the assets in the Philippines of the ultimate parent entity ("**UPE**") of at least one of the acquiring or acquired entities, including that of all entities that the UPE controls, directly or indirectly, exceeds PHP 6 billion; and
- the value of the transaction exceeds PHP 2.4 billion (subject to indexation to GDP from March 2019 onwards).

If a notification will be required, the procedure and waiting periods under the PCA and PCA-IRR will need to be observed.

An agreement that does not comply with the approval process under the PCA and PCA-IRR will be void and the parties may be subject to penalties under the PCA and PCC issuances.

Employment

The Philippines recognizes and guarantees the employees' right to security of tenure and to form organizations for their collective benefit and welfare. Employees' right to security of tenure means that they can be removed from their jobs only for one of the specified just and authorized causes and after the observance of procedural due process defined by law. In cases of valid removals, severance payments may be required, depending on the cause of the removal.

Share sale

If the acquirer buys the shares of the target company, the underlying employment relationship between the target company and its employees is unlikely to be affected and will not require any action by the buyer.

Asset sale

The general rule is that employee contracts are considered personal contracts and the buyer in good faith has no obligation to absorb employees of the seller or to continue employing them. However, this general rule is not absolute. In certain cases, the Philippine Supreme Court has been known to disregard the personal nature of labor contracts and hold the buyer, the seller or both liable in transactions deemed not to have occurred in good faith.

Tax

Capital gains tax ("**CGT**")

CGT is payable at a rate of 5% to 10% on the sale or disposition of unlisted shares by non-resident foreign corporations.

If the fair market value of the shares sold exceeds the amount of cash and/or the fair market value of the property received by the seller or transferor, the excess will be considered a "gift" subject to donor's tax.

In the case of an asset sale, corporate income tax is payable at the rate of 30% (except land and/or buildings and shares, which are subject to special tax rates).

There is no tax payable in the case of a merger.

Stamp duty

Stamp duty is payable at a rate of PHP 1.50 on each PHP 200 of the par value or 50% of the DST paid upon original issuance of no-par shares for a transfer of shares.

Further, in respect of transfers of real property, DST at the rate of 1.5% is payable on deeds of sale, conveyances and donations of real property.

In mergers, the issuance of shares by the surviving corporation is subject to a DST of PHP 2 on each PHP 200 (or fractional part thereof) of the par value of the shares. However, transfers of stock or real property pursuant to the merger are exempt from DST, provided the requirements of the Tax Code are met.

Finally, sales or exchanges of shares of stock listed and traded in the Philippine Stock Exchange ("**PSE**") are exempt from DST.

Value added tax

The Tax Code imposes value added tax ("**VAT**") on the sale of goods or properties and the performance of services in the course of business. The VAT is imposed at the rate of 12% of the gross selling price of the goods or properties sold, i.e., the total amount of money that the buyer pays or is obligated to pay to the seller in consideration for the sale.

There is no VAT on a normal share acquisition. The transfer of the assets of absorbed corporations to another corporation pursuant to a merger is not subject to VAT.

Post-acquisition integration

N/A

Common deal structures

What are the key private M&A deal structures?

Acquisitions are the most common form of M&A transaction. Acquisitions may be structured in one of two ways: the acquiring entity may acquire shares from the shareholders of the target company (share acquisition) or acquire assets directly from the target company (asset acquisition). In a share acquisition, the acquiring entity acquires the target company, or an interest in the target company, and, indirectly, the latter's business, assets and liabilities. In an asset acquisition, the acquiring entity generally acquires only specific assets, contracts and corresponding liabilities of the target company.

Auction processes are used with increasing frequency, with binding bid offers at the final offer stage.

The Philippines also recognizes the concept of a statutory merger or consolidation. In a merger, the surviving company absorbs a target company. In a consolidation, two or more companies consolidate to form a new corporation.

Mergers and consolidations are procedurally more complicated to effect than a share acquisition or an asset acquisition, and require the approval of the Philippine Securities and Exchange Commission ("**SEC**").

In a merger, the surviving corporation, which will be one of the constituent corporations to the merger, absorbs all of the assets and liabilities of the constituent corporations. In a consolidation, a new corporation — called the 'consolidated corporation' — acquires and assumes all the assets, rights, franchises and liabilities of the constituent corporation, similar to the surviving corporation in a merger.

Effectively, a merger or consolidation is a combination of two transactions, namely:

- an asset or business sale by the absorbed corporation (as the seller) in favor of the surviving corporation or consolidated corporation (as a buyer); and
- the dissolution of the absorbed corporation by operation of law when the merger or consolidation becomes effective.

The absorbed corporation(s) may be viewed as the seller(s), but because it will dissolve by operation of law after the merger or consolidation becomes effective, it may not receive the consideration for the transfer of its assets to the surviving corporation or consolidated corporation. Instead, what normally happens in a merger or consolidation is that the surviving corporation or consolidated corporation, as the case may be, issues shares to the stockholders of the absorbed corporation(s) as consideration for the transfer of assets of the absorbed corporation(s).

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

There are three forms of business vehicles that are recognized in the Philippines:

- sole proprietorships;
- partnerships; and
- corporations.

Of the three, the corporation is generally the most common.

Unlike a sole proprietor and a general partner (who have unlimited liability), the liability of shareholders of an incorporated stock corporation is generally limited to their investment in the corporation.

Foreign corporations may register branch offices, representative offices, regional headquarters or regional operating headquarters in the Philippines, and do business through such registered entities, without incorporating a stock corporation in the Philippines.

There are substantial differences between the laws and regulations that apply in M&A involving public companies and those that apply in M&A involving private companies.

What are the different types of limited liability companies?

A Philippine incorporated stock corporation is the only type of limited liability company in the Philippines. A stock corporation has a juridical personality separate from its stockholders, and the liability of the stockholders for the obligations of the stock corporation is limited to their investment in the capital stock of the stock corporation.

Subject to compliance with nationality restrictions in certain industries, where applicable, a foreign corporation may incorporate a stock corporation in the Philippines.

Is there a restriction on shareholder numbers?

There is no maximum number of shareholders applicable to a Philippine incorporated stock corporation, which is the only type of limited liability company in the Philippines. However, a Philippine stock corporation must have at least two individual shareholders, irrespective of whether the corporation also has juridical shareholders.

What are the key features of a share sale and purchase?

A share acquisition is procedurally simpler and tends to be more widely used than an asset acquisition. A share acquisition basically involves the transfer from the shareholders of the target company to the buyer of the shares in the target company. In such transactions, specifically where the buyer acquires all of the outstanding shares of the target company, the buyer effectively acquires the target company with all of its assets and liabilities (including contingent and undisclosed liabilities).

What are the key features of an asset sale and purchase?

An asset acquisition tends to be more complex than a share acquisition because the former transaction may involve the transfer of various categories of assets and liabilities to the buyer. The transfer of each category of assets and liabilities may require different legal requirements and documentation.

Unlike a share acquisition, in an asset acquisition the seller generally retains all assets and liabilities not otherwise acquired or assumed by the buyer.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

It is customary to prepare a letter of intent or term sheet at the beginning of the transaction.

A letter of intent or term sheet is not generally binding on the parties, except when expressly provided therein. A letter of intent or term sheet would normally provide which provisions are binding on the parties.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: Yes, it is common practice to include a provision on exclusivity.
- Break fee: A break fee is not common.
- Confidentiality: Yes, it is also common practice to include a provision providing for confidentiality.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

No. It is not common for separate agreements on exclusivity, confidentiality and break fees to be subsequently entered into by the parties. However, these terms may be further negotiated and corresponding provisions may be included in the definitive agreements (i.e., asset purchase agreement/share purchase agreement).

Is there a duty or obligation to negotiate in good faith?

Yes, the Civil Code of the Philippines ("**Civil Code**") provides that "every person must, in the exercise of his rights and in the performance of his duties, act with justice, give everyone his due, and observe honesty and good faith." A party may claim damages for negotiating in bad faith under the foregoing provision of the Civil Code.

Moreover, a claim for damages may also be made under the following provisions of the Civil Code:

- Art. 20: Every person who, contrary to law, willfully or negligently causes damage to another shall indemnify the latter for the same.
- Art. 21: Any person who willfully causes loss or injury to another in a manner that is contrary to morals, good customs or public policy shall compensate the latter for the damage.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: fairly common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: working capital and NAV are fairly common.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: the buyer usually bears the responsibility of ensuring the target company prepares this.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely.

Is an earn-out common?

Frequency/market practice: rarely.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: rarely.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: rarely; this is typically only available where there is a long period before execution and completion.

Is the MAE general or specific?

Frequency/market practice: both are seen.

Is the MAE quantified?

Frequency/market practice: rarely.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common; this depends on the industry.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: waterfall provisions are rarely used.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common (in conjunction with a non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; we generally get this for private deals.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: it is rare to update warranty disclosure. Notification of possible breach is more common. In the case of a material breach, a right to terminate is fairly common.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen but are often not quantified (other than specific warranties, e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are growing. There is a trend towards a limitation to actual knowledge of a specified list of senior management.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common.

Is disclosure of the data room common?

Frequency/market practice: rarely; it varies case by case.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: repetition at completion is fairly common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: it is fairly common to have simultaneous signing and closing.

Is a bring-down certificate at closing common?

Frequency/market practice: bring-down certificates at completion are fairly common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate in all material respects is a fairly common standard, but with a carve-out for fundamental representations, which must be absolutely true.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely; double materiality is usually avoided.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: it is commonly less than 100%. Bigger deals in terms of purchase price tend to have a lower aggregate cap.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: this is determined on a case-by-case basis, but a liability cap on warranties only is more common.

What are the common exceptions to the cap?

Frequency/market practice: a waiver/limitation of liability for fraud and gross negligence is void under Philippine law; carve-outs of key or fundamental warranties (e.g., title, capitalization, authority) from the liability cap are more common.

Is a deductible or basket common?

Frequency/market practice: fairly common.

Is a de minimis common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: a cap on the period of survival is fairly common, but the period varies case by case.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: carve-outs on survival of liability for tax and fraud are common.

Is warranty insurance common?

Frequency/market practice: rarely.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: rarely.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common; this is determined on a case-by-case basis.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common; this is determined on a case-by-case basis.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: rarely; this is not required and not usually stipulated in the purchase agreement.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: rarely.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes, subject to certain conditions.

What is the common governing law?

Frequency/market practice: Philippine law is generally adopted.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is more common; the place of arbitration is subject to agreement of parties.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: stamp duty is payable on share transfer (0.75% of par value of the shares of stock sold) and sale of real property (1.5% based on whichever is higher between the consideration and fair market value). The liable party depends on the contract. It is more common to see the buyer assuming liability as the seller normally shoulders the capital gains tax.

Is a separate tax covenant / indemnity or tax deed common?

Frequency/market practice: it is fairly common to have a tax indemnity, usually included in the purchase agreement.

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Guide to Navigating Global Private M&A

Poland

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

It is most common to finalize the due diligence before execution of the acquisition agreement. In rare cases, the parties agree on a confirmatory due diligence after signing or completion of the transaction, either full or limited to specific fields. Depending on the timing of this due diligence, it may be a condition to closing or release of deposit, escrow amount or part of the purchase price to the seller.

The scope of legal due diligence depends a lot on the target, but typically covers corporate, real property, employment, regulatory, financing, material contracts, litigation, environmental issues, IP/IT and data protection. Taking into account the limitations described below on the acquisition of agricultural real property not only by foreigners but also by Polish entities, the verification of the title to the real property (both in ownership and perpetual usufruct) and the status of real property are crucial issues before the acquisition of shares and real property assets.

In addition to legal, tax, financial, environmental and compliance due diligence, it is also increasingly common in Poland to conduct IT-specific due diligence.

Based on due diligence, the parties will identify not only the issues requiring rectification as conditions precedent to closing, but also additional measures of protection to be provided to the buyer under the purchase agreement, e.g., specific representations and warranties, indemnifications, price retention mechanism (most commonly escrow account or deferred purchase price payment) or reduction of the purchase price.

Independent appraisal

For both share and asset transactions, there is no legal requirement to have an independent appraisal report to support the valuation of the company or assets, respectively.

In an asset deal, Polish law distinguishes between the acquisition of assets and business as a going concern. A proper qualification of an asset deal is crucial from a tax perspective and should be performed by the tax advisers.

Payment

There are no specific restrictions regarding payment of the purchase price in Poland. The purchase price may be expressed and paid in any currency. It is usually wire transferred to the seller on the closing day or deposited in an escrow account before completion of the transaction, with release instructions to be signed upon closing. In the case of acquisition of shares in joint-stock companies, payments are quite often made with an intermediation of a brokerage house.

Signing/closing

It is most common, especially in share deals, for the transaction to be completed in two stages, i.e., signing and closing. Usually, closing is conditional upon satisfaction of specific conditions precedent agreed between the parties or set by law, such as obtaining regulatory approvals (e.g., merger control or FDI approval) or waivers/consents of third parties to the transaction (change of control clauses), completing restructuring (e.g., spin offs, asset carve-outs), obtaining financing for the transaction, or rectifying certain issues discovered during due diligence process.

In asset deals, one of the crucial conditions to closing is usually obtaining creditors' consents for the transfer of all (or material) contracts, as this is a legal requirement for an effective transfer of a contract in an asset transaction.

Approvals/registrations

Foreign investment

There are several regimes directed at screening investments in Poland. Some apply regardless of the investor's country of origin. Merger control

Polish antitrust law prohibits any acquisition or merger that would have the tendency to lessen competition or create a monopoly. Although a number of factors are considered when assessing the effect of a transaction on competition, market concentration is commonly the most important factor. Generally, a combined market share not exceeding 20% (in a transaction between competitors) or 30% (in a transaction between non-competitors) is not likely to attract the attention of the Polish Competition Authority ("**PCA**").

If a transaction meets the statutory thresholds, a notification must be filed with the PCA before the completion of that transaction. In general, the filing thresholds are:

- the combined worldwide turnover of the undertakings participating in the transaction in the financial year preceding the year of the notification exceeds the equivalent of EUR 1 billion; or
- the combined turnover of the undertakings participating in the transaction in Poland in the financial year preceding the year of the notification exceeds the equivalent of EUR 50 million,

provided that none of the statutory exemptions apply. The most important statutory exemption is a situation when:

- the combined turnover of the target undertaking and its subsidiaries did not exceed, in Poland, in either of the two financial years preceding the notification, the equivalent of EUR 10 million

There are two phases of review. The first phase lasts up to one month. If the case merits extensive markets analysis, a second phase will be initiated. That second phase will last no longer than an additional four months. During these phases, the PCA has the right to request additional information. Any requests for information stop the clock until the PCA has received the requested information. In the case of remedies (conditions), the statutory review period will be extended for an additional 14 days.

Other regulatory or government approvals

Permit for acquisition of real property or shares in a company holding real property

Purchasing real property by foreigners is governed by the provisions on Purchase of Real Estate by Foreigners. With certain exceptions (e.g., a company's transformation), a permit is required in each case of real property purchase (i.e., acquisition of ownership title or perpetual usufruct right to real property or purchase, or taking up of shares in a company that has a registered place of business in Poland and is the legal owner or perpetual usufructuary of the real property). A permit is required if, by purchasing shares in a company that is the legal owner or perpetual usufructuary of real property, a foreigner will take control of that company, or if shares in an already-controlled company are acquired or taken up by a foreigner who is not the company's shareholder. The Minister of Internal Affairs may grant the foreigner a permit to purchase real property or shares in a company owning real property if there is no probability of threat to national security, public safety or public order, and if the foreigner can demonstrate the existence of circumstances confirming the foreigner's ties with Poland.

In general, the above obligation does not apply to residents of the European Economic Area.

Acquisition of agricultural real property or shares in a company holding agricultural real property

The Act on Shaping Agricultural System introduced several limitations on the transfer of the legal title to agricultural real property, transfer of shares in companies holding agricultural property or reorganizations of companies holding ownership or perpetual usufruct rights to agricultural real property.

In principle, the agricultural land may only be acquired by persons meeting certain criteria (such as individual farmers). Other entities are obliged to obtain the consent of the Head of the National Agricultural Support Centre ("**NASC**") before the effective transfer of the title to the land. There are several exceptions to this. Among others, the limitations do not apply to agricultural real property of specific size or located on the areas designated in the local zoning plans for non-agricultural purposes.

The NASC also has a pre-emptive right in relation to the purchase of shares in companies that hold ownership title to agricultural real property. This pre-emptive right does not apply to the sale of stocks on the stock exchange.

The NASC also has various other rights relating to mergers, divisions, transformations and acquisitions of shares in companies holding the agricultural real property. These limitations are taken into account when structuring the transaction, most commonly as conditions to closing.

Additionally, other state agencies (e.g., State Forests, communes) may be granted a pre-emptive right on the basis of other regulations, depending on the status and location of the real property. Therefore, it is important to verify the status of the real property before the transaction.

Special Economic Zones

Specific limitations also apply to the sale of real property located in Special Economic Zones. In this case, the Special Economic Zone's managing entity has a pre-emptive right to acquire the land.

Other regulatory requirements

For acquisitions of control of financial institutions (e.g., banks, insurance companies, investment and pension funds or investment firms) and of companies operating in specific sectors, such as telecommunication, energy, media, airway and railway transport sectors, the approval of the relevant industry regulator is usually required before the share sale transaction due to change of control. The definition of control and the rules for the issuance of this regulatory approval vary according to the rules of the specific regulatory authority, depending on the specific sector or industry. These regulations are applied equally to foreign and domestic investors.

In asset transactions in a regulated industry or sector, it is commonly required to obtain new permits and approvals for operation.

Employment

Share sale

In share acquisitions, there is no change in the employer/employee relationship, so consent from employees or unions is not required. Notice to employees, unions or works councils is also not required, unless some changes in the employment sphere are known to the employer, e.g., planned redundancies or changes in organization of work (in which case, the works council should be informed, and in some circumstances consulted).

Asset sale

The employee transfer procedure is fairly simple. In an asset acquisition that involves the transfer of a business as a going concern or its part, the employees transfer automatically. Polish law requires notification of unions or the employees (if there is no union) 30 days in advance of the transfer.

The transfer of employees as a result of the transfer of the business or its part does not require the termination of the employment agreements. Labor law foresees the transfer of the same employment terms and conditions to the acquiring company if the employees transfer together with the assets, as part of the economic activity. In the case of a part business transfer, the former employer and new employer are, by virtue of law, jointly and severally liable for the labor-related liabilities resulting from the period before the transfer. In the case of a full business transfer, the new employer is liable for any such liabilities.

The employees may terminate their employment agreements within two months of the transfer by serving the employer seven days' notice. This termination does not trigger payment of the severance pay, unless termination was caused by a severe change of the terms or conditions proposed or introduced by the employer.

Termination of the employees due to reasons solely related to the transfer is not allowed. However, termination as a result of post-transfer harmonization is justified.

Tax

Share sale

The sale of shares in a Polish company is subject to 1% transfer tax, irrespective of the residency of the parties to the agreement and the place where the sale agreement was signed. The sale of shares is normally out of the scope of (or exempt from) Polish VAT.

From the perspective of a Polish corporate or individual seller, the capital gains on the sale of the shares will be subject to 19% CIT or personal income tax ("**PIT**"). Additionally, a so called solidarity surcharge of 4% is applicable for individuals (if their total income for the tax year exceeds PLN 1 mln - on excess of the income over PLN 1 million). There is no universal participation exemption regime under which these capital gains could be exempt from taxation.

For foreign sellers of shares (both individuals and entities), capital gains will also be subject to income tax (CIT/PIT) at the rate of 19%, if the capital gain is deemed to be from a Polish source. Foreign sellers can also be protected from Polish taxation under the relevant tax treaty. If the foreign seller is domiciled in a jurisdiction defined by the Polish tax rules as a low-tax jurisdiction, 19% withholding tax on the payment may be applicable.

The tax loss carryforward of a company that has been subject to a change of control will continue to be carried forward, despite the change of control, pursuant to the general rules.

In a share deal, all (hidden) tax arrears of the acquired company (i.e., the target) in the past will be inherited by the buyer. Carrying out due diligence is therefore of utmost importance. The statute of limitations in Poland is generally five years following the end of the year during which the deadline for paying the tax liability has lapsed.

Asset sale

The transfer of assets will normally be subject to CIT at the rate of 19% in the hands of the seller. As a result, the purchase will lead to a step-up in basis in the hands of the buyer, including goodwill on the sale of enterprise or its organized part. In an asset deal, it is generally possible to offset the financing costs (if any) against the income from the acquired assets/business.

The sale of assets is normally subject to VAT at the standard rate of 23%. The transfer of certain assets, and as a rule, the transfer of going concern may be out of scope or exempt from VAT. The VAT due on the transfer is normally paid by the buyer to the seller, who will remit such VAT to the tax authorities.

Transfer of going concern, being out of the scope of VAT, is subject to transfer tax at the rate of 1% (goodwill, property rights) or 2% (movable and real estate assets).

The buyer of assets qualifying as an enterprise or organized part of enterprise can be held jointly liable for almost all of the tax arrears of the seller related to the seller's business activity, up to the value of the acquired enterprise or organized part of enterprise. Joint liability can be avoided if a "clean" certificate (i.e., a certificate confirming that the seller has not defaulted on its tax obligations and has no tax arrears) is obtained from the relevant authority.

Post-acquisition integration

Post-acquisition integration in Poland covers standard procedures and actions such as updates of relevant public registers, notifications of authorities and contractual parties, financing, tax, accounting, employment and IT integration, as well as an update of the beneficial ownership register. These aspects should be analyzed in advance of the process and planned in detail well before initiation of the integration, particularly in the case of regulated business requiring specific permits. The parties may need to develop a plan and agree on a certain transition of agreements to establish the rights and obligations of each party to operate the business until the completion of the transfer of permits.

For share acquisitions, the typical method of integration in Poland is a merger performed in accordance with commercial law provisions. The process takes approximately four months and involves formal steps and documents to be executed and submitted to the registry court within the specific timeframe. The cooperation of the merging companies and shareholders as well as accountants and tax advisers needs to be ensured during the process. The merger procedure requires the preparation of the valuation of the company subject to acquisition and other accounting information.

If the companies have employees, the merger will also require employment-related steps to be taken similar to those described above under "Employment." In particular, if employment restructuring or redundancies are planned, these would have to be taken into account while planning the integration, as additional obligations for employers will arise.

Common deal structures

What are the key private M&A deal structures?

In Poland, a business can be purchased by way of a share purchase or an asset purchase (either through the acquisition of: (i) specific assets of the target; or (ii) part of or the entire enterprise of the target). A merger and other forms of corporate reorganization are also available, although merger is often used as a vehicle for post-acquisition integration, rather than for acquisition purposes directly. The transaction structure highly depends on the specifics of a given transaction (such as tax considerations, non-transferability of permits or specifics of the assets forming the target, etc.) and, therefore, it is generally not possible to say which transaction structure is more common.

Transactions are still usually performed by the way of direct sale of the target to an interested buyer, although auction processes are more and more common on the market. If an auction process is applied, it is usually divided into at least two stages: (i) at the first stage, interested bidders provide indicative, non-binding offers, on the basis of which those attractive for the seller are selected for the next stage of the auction; (ii) at the second stage, selected bidders are permitted to perform due diligence of the target, after which they are requested to submit a binding offer, usually together with comments to the draft transaction documents. On that basis, preferred bidder(s) is/are chosen.

As regards mergers, under the Polish Commercial Companies Code ("**CCC**"), companies may merge either by transferring all the assets of the company being taken over to the company effecting the takeover in exchange for the issue of shares to the shareholders of the company being acquired, or through the creation of a new company to which the assets of the merging companies are contributed in exchange for the issue of shares. A merger may be carried out without increasing the share capital of the acquiring company if that company owns shares in the company whose assets are being acquired. A merger must be approved by and registered with the relevant registry court in order to become effective. An acquiring company or a newly formed company assumes, at the date of the merger, all the rights and obligations of the acquired company or companies merging into the newly formed company. The same applies to administrative permits, consents and reliefs; however, specific provisions of law (or the permits, consents or reliefs themselves), may contain provisions preventing such a transfer.

In general, a merger requires fewer formalities (e.g., there is no need for a shareholders' resolution, verification of the merger plan by an expert auditor, or preparing reports on the legal and economic grounds for the merger by management boards of the merging companies) where the acquiring company already holds more than 90% of the shares of the company being acquired, or the acquiring company holds 100% of the shares of the company being acquired.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

The limited liability company (*spółka z ograniczoną odpowiedzialnością/sp. z o.o.*) and the joint stock company (*spółka akcyjna/S.A.*) are the two main corporate forms in Poland. Both have legal personality with the economic liability of shareholders limited to the amount of their equity contribution. Shares in these kinds of companies are freely transferable unless their statutory documents provide otherwise.

What are the different types of limited liability companies?

The limited liability company (sp. z o.o.) is well suited to carrying out business activities of all kinds. The shareholders' liability is limited to the amount of their contributions to capital. The minimum share capital of a limited liability company is PLN 5,000. The shares are not represented by security instruments and, assuming no restriction is provided for in the articles of association, may be transferred in written form by way of signed and notarized agreement. A limited liability company is managed by a management board consisting of one or more directors appointed by the shareholders (unless the articles of association provide otherwise). The management board must be composed of one or more members. Certain strategic decisions, in particular those relating to approval of annual reports, distribution of profits, claims for the reparation of damages, etc., are made at the shareholders' meeting.

Is there a restriction on shareholder numbers?

There are no restrictions on the number of shareholders for any company. However, in companies where the share capital exceeds PLN 500,000 and the number of shareholders exceeds 25, there is an obligation to establish a supervisory board.

It must be noted that a limited liability company cannot be formed solely by another limited liability company (or foreign equivalent), although such a company can subsequently become the sole shareholder of a limited liability company.

What are the key features of a share sale and purchase?

The acquisition of a target company may be achieved by acquisition of its shares, which will result in the acquisition of the target company shareholder's rights and liabilities.

What are the key features of an asset sale and purchase?

The acquisition of a target company may be achieved by the acquisition of assets of that company. If the assets acquired, in aggregate, form an independent business, subject to meeting conditions specified in Polish legislation, such a transaction may be qualified as an acquisition of part of or an entire business. Whether a transaction involves a standard acquisition of assets or an acquisition of a business will depend on the nature of the assets being acquired. Similar but not identical concepts are used by civil, employment and tax regulations, and it needs to be analyzed on a case-by-case basis whether the assets acquired form: (i) a business from a civil law perspective; (ii) an employment establishment from an employment perspective; and/or (iii) a going concern from a tax perspective.

The acquisition of a business involves the acquisition of all elements of the business, unless specifically excluded from the transfer by the acquisition contract or by provisions of law. The acquirer of a business will be liable jointly and severally with the transferor for the transferor's debts and obligations relating to running the business unless, at the time of acquisition, the acquirer was not aware of those obligations despite having investigated this with due care. The statutory liability of the acquirer is limited to:

- the value of the acquired business at the time of the acquisition; and
- the amount owing to the creditors of the business at the time of the acquisition.

The condition and composition of the acquired business at the moment of acquisition is assumed for valuation purposes. This liability cannot be excluded or limited without the creditor's consent.

If assets to be acquired do not form a business pursuant to Polish regulations, the transaction needs to be performed on an asset-by-asset basis. In such a case, all such assets should be listed in a detailed inventory to ascertain which elements are subject to the transfer. Both the acquisition of assets and the acquisition of the business require the consent of creditors before the seller's liabilities arising out of contractual obligations relating to the acquired assets will be validly transferred.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

Letters of intent or term sheets are not often prepared. They are not binding on the parties for transaction purposes (i.e., excluding, for example, provisions on confidentiality provisions, exclusiveness, etc.), unless the parties decide otherwise.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: Depending on the transaction, if the parties agree on exclusivity for a certain bidder, particularly in auction processes, such exclusivity is usually reflected in the term sheet or a separate exclusivity letter.
- Break fee: Term sheets usually do not provide for any break fees.
- Confidentiality: Term sheets usually include provisions on confidentiality obligations.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Usually, if there is a term sheet, the relevant preliminary arrangements of the parties are covered in the term sheet (a separate NDA is sometimes signed).

Is there a duty or obligation to negotiate in good faith?

In accordance with the provisions of the Civil Code, there is a general duty to negotiate in good faith under Polish law. If there is a breach of such a duty, the breaching party is obliged to compensate the non-breaching party by paying damages that the party incurred by assuming the agreement will be concluded. The damages are limited to the costs incurred from being involved in negotiations (e.g., advisory fees, travel, accommodation, etc.) but will not include damages that the non-breaching party incurred due to the fact that the planned agreement has not been concluded and performed.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: purchase price adjustments are common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: various types are seen, while cash-free, debt-free and working capital adjustments are the most common. The 'locked box' mechanism is also popular for the most sought-after assets.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually prepared by the target company on instruction by the seller, and verified post-completion by the buyer.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely.

Is an earn-out common?

Frequency/market practice: fairly common; earn-outs are common in private equity transactions when sellers continue to manage the target company after closing. They are also increasingly common to bridge valuation gaps. Otherwise, they are not very common.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: an escrow is fairly common as a completion mechanism to ensure price payments, which, in the case of acquisition of shares in joint-stock companies, is replaced with an intermediation of a brokerage house. It is increasingly less common as collateral of the seller's liability for representations and warranties (although it depends on the bargaining position of the parties).

Is a break fee common?

Frequency/market practice: fairly common.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common, especially in case of long period between signing and closing.

Is the MAE general or specific?

Frequency/market practice: the MAE is becoming more and more specific. In connection with COVID-19, there is a tendency to expressly indicate that the parties have properly evaluated the risks connected with the same and any such circumstances shall not constitute the MAE.

Is the MAE quantified?

Frequency/market practice: fairly common; increasingly common.

Covenants

Is a non-compete common?

Frequency/market practice: a non-compete is fairly common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: blue pencil provisions are common. Waterfall provisions are not so common.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common (in conjunction with a non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: fairly common; interim period covenants are quite common, especially if the locked box mechanism is applied.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; there are competition law issues around potential "gun-jumping."

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: fairly common; it is common to update warranty disclosures. There is usually no consequence as long as updates do not result in MAE.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen. Quantification by a certain amount is often used (if applicable).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: this entirely depends on the relative bargaining positions (from imputed to actual knowledge).

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common; it is still commonly requested by buyers, but often resisted by sellers.

Is disclosure of the data room common?

Frequency/market practice: fairly common; it is common to include a data room index or data room documents in annex to the agreement with a reverse representation of the buyer.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common; repetition at completion is common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: rarely.

Is a bring-down certificate at closing common?

Frequency/market practice: rarely; a bring-down certificate at completion is not very common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true, complete, accurate and not misleading in all material respects is quite common. There is, however, a tendency to limit the standard to true and accurate only.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: it is commonly 100% for the title to the shares only. Mid-cap and larger deals see lower caps, e.g., 10%-30%. Key warranties and/or specific indemnities (in particular tax and solvency) are usually not capped or capped at 100%.

The cap for non-key warranties is usually within the range of 10-30% of the purchase price.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: they usually apply to warranties and damages claims (with respect to the scope of damage and its kind).

What are the common exceptions to the cap?

Frequency/market practice: key warranties and tax warranties are often excepted or limited with a higher cap. Specific indemnities are usually limited to 100% of the price or not capped at all. Liability for fraud (willful misconduct) may not be limited by the parties due to statutory limitations.

Is a deductible or basket common?

Frequency/market practice: both are fairly common. Deductible is more often resisted and a tipping basket is more common.

Is a de minimis common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: operational warranties: 12-24 months; key warranties: 5-10 years (e.g., title and capacity etc.); tax: 6-7 years (statute of limitations period). Liability for fraud (willful misconduct) may not be limited by the parties due to statutory limitations.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: tax: 6-7 years (statute of limitations period); title warranties: sometimes not limited in time. Liability for fraud (willful misconduct) may not be limited by the parties due to statutory limitations.

Is warranty insurance common?

Frequency/market practice: fairly common; R&W insurance is becoming more and more common.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common; common for actually received.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common; common for actually received.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common; common for actually received.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: fairly common; additionally required by law.

Is there an exclusion of consequential damages?

Frequency/market practice: very common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: fairly common; it is common to provide for a representation from the buyer that, except as disclosed in the agreement, it is not aware of any breach of the representations at the time of closing.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: Polish law is the most common choice (unless the Polish target is part of a multijurisdictional transaction).

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: both common; if arbitration, usually either the Polish Chamber of Commerce or arbitration ad hoc under UNCITRAL (Warsaw is common as a venue). Sometimes ICC Stockholm or Vienna is used.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: no stamp duty applies. Transfer tax applies (unless a brokerage house is involved) and is borne by the buyer according to the statutory provisions. Notarial fees are usually borne by the buyer, but are sometimes shared.

Is a separate tax covenant / indemnity or tax deed common?

Frequency/market practice: fairly common; it is common to have tax representations and warranties/relevant indemnity included in the purchase agreement.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

People's Republic of China

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

In China, regulatory non-compliance used to be very common but we see a growing trend of improvement. Regulatory non-compliance examples generally include underpayment of social insurance for employees, violation of overtime policies and breaches of environmental laws. Often, these issues will mean additional costs for rectification and operations post-closing. In certain sectors, e.g., energy and resources, healthcare, telecommunications, non-compliance issues in business practices such as bribery can be prevalent. These issues may erode deal value and in some situations may lead to the buyer walking away. For buyers from certain countries, this may also trigger obligations to report to regulators in their home jurisdictions.

In some jurisdictions, asking the seller to clean up before closing will be the norm. However, this is not necessarily the case for every situation in China. Coming up with an appropriate solution requires detailed due diligence and a deep understanding of the local practice and practical risks involved. Seeking protection via a reduction in the purchase price or a holdback of the purchase price may also be advisable.

Pricing and payment

Independent appraisal

Where there is an onshore acquisition in China, and the target is a domestic Chinese entity, an independent appraisal will be required for tax filing purposes. In practice, the parties often will negotiate the price and work together to ensure the appraised value is aligned with the agreed price to the extent possible. Where the seller is a Chinese entity, it is common for the seller to ask for payment outside of China in order to minimize Chinese taxes payable. They may also seek to create structures that could be exposed to tax and regulatory risks. From the buyer's perspective, accommodating such structures and weighing such accommodation against the risks involved is a balancing act.

Payment

Where the seller is a Chinese party and the buyer is a foreign party, the purchase price will need to be paid into a designated account in China opened in the seller's name.

Where the buyer is a Chinese party and the seller is a foreign party, the timeline for closing is typically longer as the Chinese buyer will need to present evidence of payment (or exemption) of Chinese capital gains tax, if any, before it can apply to its bank to remit the purchase price to the foreign seller. As such, it is common to request that the purchase price (or part thereof) be paid into an onshore escrow account upon the signing of the share purchase agreement.

In case of a direct acquisition of a Chinese company (shares or assets), a regulation issued by the Ministry of Commerce ("**MOFCOM**") in 2009 ("**M&A Regulation**") requires that the purchase price be paid in full within one year of closing. This makes the structuring of any deferred or earn-out payment very challenging. However, with the newly issued Foreign Investment Law ("**FIL**") coming into force as from 1 January 2020, the effectiveness of the said regulation has been placed into question. There are generally no restrictions in the case of an indirect acquisition.

Signing/closing considerations

Share sale

As government approval and/or registration is required for a direct transfer (onshore acquisition) of shares in a Chinese company to a foreign buyer, there is normally a gap between signing and closing.

On the other hand, where the Chinese company is owned by a special purpose vehicle ("**SPV**") outside China, it is common for the deal to be transacted as an offshore transfer of shares in the SPV. Apart from Chinese merger control filing (which may apply if thresholds are met), the transfer of shares in the SPV is not subject to Chinese government approval or registration (except for a post-completion reporting of change of beneficial owner) and a simultaneous sign and close is possible.

Asset sale

Unless the foreign buyer already has existing entities with the requisite business scope in China to acquire the assets, normally there will be a gap between signing and closing.

Approvals/registrations

Foreign investment

A transfer of shares in a Chinese company is effected by means of an equity transfer contract between the buyer and the seller. The change of shareholder as a result of the equity transfer, and other related changes in corporate particulars of the target company, will need to be registered with the local business registry.

In an asset deal, the foreign buyer may need to establish a new entity to acquire the assets. The establishment of an entity could take a month to complete and, where licenses are required (such as manufacturing), could take several months to complete.

If an existing Chinese subsidiary of the foreign buyer is used to act as the asset buyer, it is necessary to ensure that its business scope is broad enough to cover the acquired business post-closing. Amendment of business scope is subject to registration procedures with the local business registry. It may also be necessary for the asset buyer to establish additional branches to operate the business if the acquired business is in a different location than where the subsidiary is registered.

The timing for such registration or establishment of branches varies depending on the location and whether the target company is regulated. It could range from a few weeks to a few months.

Merger control (antitrust/competition approval)

Any transaction resulting in a party acquiring control or decisive influence (concentration) must be reported for clearance to the SAMR if the following thresholds are met:

- all participating business operators' combined worldwide revenue in the previous accounting year is over RMB 10 billion, and at least two business operators have PRC revenue over RMB 400 million each; or
- all participating business operators' combined PRC revenue in the previous accounting year is over RMB 2 billion, and at least two business operators have PRC revenue over RMB 400 million each.

SAMR has discretion to investigate any transaction that fails to meet the thresholds, but it has, so far, not yet exercised this discretion.

Merger control filings could take 30 days (from the date the application is formally accepted) under the simplified procedures or it may take up to three months or longer to complete under normal procedures.

Other regulatory or government approvals

If the target is state-owned, approval or recordal may be required from the State-Owned Assets Supervision and Administration Commission or its local counterpart. A public listing of the shares or assets in question at an authorized property rights exchange would also be required with limited exceptions to apply.

For acquisitions in certain sectors, such as telecommunications, general aviation and healthcare, approval from the relevant industry regulator is also required.

For targets that engage in infrastructure projects, approval by or recordal with the National Development and Reform Commission ("**NDRC**") or its local counterpart is required. If the target is in a sensitive industry sector (e.g., dual-use technologies), the acquisition of such target by a foreign buyer is also subject to a separate national security review administered by MOFCOM.

Employment

In case of share transfers, as there is no change of employment relationship, consent from employees or labor unions is not required. However, it will still be important to manage employee issues as there are examples where employees may make additional demands (e.g., payment of severance or signing of new agreements) even though these demands are not supported by law.

In case of business transfers, employees will need to be terminated and rehired. Severance is either paid at the time of the termination/rehire or deferred by recognizing the previous years of service of the employees.

Tax

Stamp duty of 0.05% of the consideration is payable by each party in the case of a share sale (a total of 0.1%). Stamp duty of 0.03% (inventories and used fixed assets) and 0.05% (other assets) applies in the case of an asset sale. Stamp duty should be borne separately by the buyer and seller but they can contractually agree otherwise. By way of illustration, in respect of transfer of inventories and used fixed assets, buyer and seller are each separately liable to pay stamp duty at 0.03% on the contract value. In other words, a total of 0.06%.

For Chinese corporate sellers, capital gains will form part of their profits and will be subject to enterprise income tax at the rate of 25%. For Chinese individuals, Chinese capital gains tax is 20%. For foreign sellers of shares, capital gains are subject to 10% withholding tax, unless reduced by a tax treaty.

Post-acquisition integration

Buyers are realizing that the real challenge when acquiring a new business starts only when the deal closes and are focusing more on how to derive value from their acquisitions. Where the existing and target businesses operate in the same or complementary fields, the acquirer almost always wants to integrate the two businesses in order to save costs and develop synergies. It is important to plan for post-acquisition integration well advance of closing.

Recent developments

The most significant development for foreign M&A in China is the implementation of the FIL and the revamping of the laws governing foreign investment that began in 2020. The FIL and the FIL Implementing Regulations replaced the laws and regulations that had governed foreign investments in China for several decades. This marked a new era for the management of foreign investment in China, including acquisitions by foreign investors and their subsidiaries in China.

At the same time, China's foreign exchange regulator, the State Administration of Foreign Exchange ("**SAFE**"), liberalized certain restrictions on foreign exchange capital accounts and issued a circular in late 2019 that allows foreign-invested enterprises ("**FIEs**") to use their registered capital to make investments in China. Previously, except for specially approved foreign-invested investment company and venture capital enterprises, FIEs were only permitted to use their accrued profits to invest in or acquire equity of other enterprises. Under the new policy, all FIEs, not just specialized investment companies, can use its injected capital or borrowed loans to acquire and hold interests in other Chinese entities. As a result, foreign investors have more options and flexibility to structure acquisitions in China.

Common deal structures

What are the key private M&A deal structures?

A foreign investor wishing to acquire or increase its equity in a target company registered in the People's Republic of China ("**PRC**") would commonly do so in one of the following ways:

- direct acquisition, where the foreign investor buys all or part of the equity of the PRC target companyor subscribes for an increase in capital of the target directly;
- offshore/indirect acquisition, where the foreign investor acquires or increases equity of the PRC target company via the offshore purchase of or subscription for an increase in equity in the target's foreign parent(s); or
- asset acquisition, where a foreign investor, using a new and existing FIE as the acquiring vehicle, directly buys some or all of the business and assets of the PRC target company.

State-Owned Interests and Special Types of Acquisition: The Law of the PRC on the State-owned Assets of Enterprises, passed in October 2008, was a reminder of how significant state-owned enterprises (SOEs) are in the Chinese national economy. It remains the Chinese government's objective to spin off SOEs in less sensitive sectors, particularly SOEs in poor financial shape. Since early 2003, foreign investors have been allowed to acquire domestic creditors' rights (debts) in the target SOE and thereby qualify for the opportunity to later convert such debts into equity in the company (similar to a convertible bond). The normal means of direct equity or asset acquisition applicable to regular companies outlined above will also apply, with certain special rules and restrictions. Such acquisitions could also raise other issues, such as state-asset valuations and employee resettlement issues.

It is a mandatory requirement under the PRC law that transfer of state-owned assets and equities shall be conducted through a listing and bidding process at an authorized property rights exchange center. Apart from the above, for private deals, auction processes are also seen in some M&A deals of relatively large sizes. Bid process letters are not commonly used in transfer of state-owned assets and equities administered by exchange centers. In contrast, in auction deals led by private sellers, bid process letters are typically used, and both non-binding indicative bid letters and binding letters at final offer stage are commonly seen in China.

Scheme of arrangement is not applicable under the PRC law.

Mergers: Western-style mergers between two or more companies are possible but are rarely seen in the PRC. Current PRC statutory mechanisms recognize two means of mergers: a merger by absorption and a merger by new establishment. A merger by absorption involves one company absorbing another, after which the absorbed company is dissolved and its registered capital and assets are merged into the surviving entity. In a merger by new establishment, both pre-merger companies are dissolved and a new company is established, holding an aggregate of the pre-merger companies' assets and registered capital. Generally, the post-merger entity would be a complete successor to the pre-merger entities, that is, it would assume all rights and liabilities of those pre-merger entities. However, creditors of the participating companies may opt to have their claims repaid in full before the completion of the merger.

Cross-border mergers are currently unavailable under PRC law, i.e., it is not possible to directly merge a foreign entity with a domestic company (including FIEs). For foreign investors, the only permissible forms of mergers in China are between FIEs and FIEs, or between FIEs and domestic companies.

Generally speaking, share and equity acquisition are more common than asset acquisition since asset deals are usually more time-consuming and complicated to execute. For instance, in an asset deal, the purchaser may need to set up a new entity with local registration authority to take over the transferred assets as well as the transferred employees (if the purchaser does not have an existing suitable entity in China). In addition, permits and licenses are not automatically transferrable in an asset deal. The purchaser's entity may need to apply anew for the necessary permits and licenses in its own name before it can operate the acquired business and assets. Transfer of employees would entail termination of the contracts with the seller and execution of new contracts with the purchaser entity.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

Traditionally, foreign investors usually establish a presence in the PRC via one or more of the following legal forms:

- representative offices;
- Sino-foreign joint ventures ("**JV**");
- wholly foreign-owned enterprises ("**WFOE**"); or
- foreign-invested joint stock limited companies ("**FISC**").

The latest option is the foreign-invested partnership ("**FIP**"). The more flexible FIP form is now starting to replace the foreign-invested venture capital enterprise (a form of a PRC vehicle used by some international investors to acquire Chinese targets), particularly with PRC investment funds aimed at foreign investors.

What are the different types of limited liability companies?

A JV or a WFOE takes the form of a limited liability company (LLC) that does not issue shares but has 'registered capital', which is registered with the business registry. FISCs, currently less common in China, are share-issuing companies similar in legal form to Western-style corporations. An FIP may take the form of a limited liability partnership, which is akin to its Western-style counterparts.

Is there a restriction on shareholder numbers?

The maximum number of a limited liability company set up in the PRC is 50. For limited liability companies in certain regulated sectors (e.g., general aviation), foreign investment may be subject to ownership restriction. As a result, such companies need to have at least one Chinese shareholder and one foreign shareholder, and the foreign shareholder may only hold a minority stake depending on the business scope of the company.

What are the key features of a share sale and purchase?

A direct acquisition will take place in the PRC and will therefore be subject to full PRC approval (for industries listed under the Negative List) as well as registration information reporting requirements, which may be time-consuming and involve government discretion, i.e., the PRC authorities may withhold approval (if applicable) if they perceive problems with the transaction.

The foreign buyer in a direct share acquisition generally assumes all existing or contingent obligations and liabilities of, and restrictions applicable to, the PRC target company in proportion to its equity in the target, unless explicitly carved out or excluded before or during the transaction.

Offshore/indirect acquisition of shares: This option is available only if the PRC target companies have foreign investors. An offshore acquisition takes place in the offshore company's jurisdiction of incorporation and is generally not subject to PRC jurisdiction and review, except in certain circumstances under the PRC's antitrust and national security review regimes and PRC tax disclosures. This could change under the FIL that affords the MOFCOM or its local counterparts authority to approve certain types of offshore acquisition whereby the actual control of a domestic enterprise is transferred to a foreign investor.

In addition, if the offshore company's ultimate shareholders are PRC nationals or entities, certain PRC filings should have been made with SAFE which should be carefully reviewed during due diligence.

The foreign buyer in an indirect share acquisition generally assumes all the existing or contingent obligations and liabilities of, and restrictions applicable to, the PRC target company via the target's parent company, unless explicitly carved out or excluded before or during the transaction.

What are the key features of an asset sale and purchase?

Asset acquisitions are subject to PRC jurisdiction and relevant PRC approval requirements if the target is a non-FIE. Where the target is an FIE, although generally an asset acquisition is not subject to government approval, local practice may vary and in some localities the approval authority may insist that an asset acquisition be submitted for approval. In an asset transaction, any existing obligations and liabilities of the target, or restrictions on it, generally remain the target's sole responsibility.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

Yes, it becomes more and more common to prepare a letter of intent or term sheet for M&A deals in the PRC. While the letter of intent or term sheet is normally signed as non-binding document, it is customary to give binding effect on the following provisions: confidentiality, exclusivity for negotiation, governing law, dispute resolutions and the non-binding effect clause itself.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: Exclusivity provisions are commonly included in letters of intent or term sheets, but there are also many instances where letters of intent or term sheets do not contain exclusivity provisions.
- Break fee: Break fee provisions are not common but are sometimes seen in the market.
- Confidentiality: Confidentiality provisions are commonly included in letters of intent or term sheets.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

It is common to negotiate separate confidentiality agreements and exclusivity agreements.

Is there a duty or obligation to negotiate in good faith?

As a basic legal principle, both the PRC Contract Law and the PRC Civil Code (which will come into force on 1 January 2021 and which will combine and replace the existing civil laws including the PRC Contract Law) require the contracting parties to act in good faith in the negotiation stage. According to Article 42 of the PRC Contract Law and Article 500 of the PRC Civil Code, a party shall be liable for damages suffered by the other party if it (i) pretends to conclude a contract and negotiates in bad faith; (ii) deliberately conceals important facts relating to the conclusion of the contract or provides false information; or (iii) performs other acts which violate the principle of good faith.

Agreeing the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: very common in offshore acquisitions or onshore acquisitions of FIEs, but not very common in onshore acquisitions of domestic companies.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: cash free/debt free is very common. Working capital is also fairly common. NAV is rarely seen.

Is there a collar on the purchase price adjustment?

Frequency/market practice: collars are rarely used. This may be required where public companies are involved.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually prepared by the target company.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely.

Is an earn-out common?

Frequency/market practice: fairly common; more common in private equity transactions where sellers continue to manage the target company after closing. It is less common where the seller is completely exiting. Earn-outs are commonly capped. There are potential difficulties in implementing earn-out provisions in onshore acquisitions given the requirement for foreign investors to pay the purchase price in full within one year under the M&A Regulation.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: escrows are very commonly used by private equity investors and strategic buyers. If the Foreign M&A Regulation applies, the purchase price (including the escrow amount) must be fully settled within one year after closing, unless otherwise approved.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: rarely; this is typically only available where there is a long period before execution and completion, or in the case of a foreign seller.

Is the MAE general or specific?

Frequency/market practice: both are seen.

Is the MAE quantified?

Frequency/market practice: both quantified MAE and non-quantified MAE are seen.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common, but not from private equity sellers.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: blue pencil methods are more commonly used.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common (in conjunction with non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common (in conjunction with non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: fairly common (in conjunction with other pre-closing obligations).

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; we generally get this for private deals.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: fairly common; updating schedules is common but limited to things like lists of contracts. Notification of possible breach is common. In the case of a material breach, there is a right to terminate.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen but often not quantified (other than specific warranties, e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are growing. They are often limited to the actual knowledge and due enquiry of a specified list of senior management.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common.

Is disclosure of the data room common?

Frequency/market practice: rarely; Chinese sellers commonly require this but it is often not accepted by buyers. Chinese sellers may be reluctant to prepare specific disclosures.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common; repetition at completion is common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: it is not very common to repeat warranties at all times between signing and closing.

Is a bring-down certificate at closing common?

Frequency/market practice: rarely; bring-down certificates are not very common.

What is the applicable repetition standard e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate in all material respects is common but often carve out for fundamental representations, which must be absolutely true.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely; double materiality is usually avoided.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: the buyer will ask for 100% but it is possible to negotiate down. It ranges from 10%-100%.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: both are seen regularly.

What are the common exceptions to the cap?

Frequency/market practice: key warranties are often excepted (e.g., title, capitalization, authority). Often tax and specific areas of concern, sometimes with specific higher caps. Separate caps can be negotiated.

Is a deductible or basket common?

Frequency/market practice: rarely; it is becoming more accepted in the market.

Is a de minimis common?

Frequency/market practice: rarely; it is becoming more accepted in the market.

How long does seller liability survive?

Frequency/market practice: a general survival of 18-24 months is common. Tax is commonly longer than general warranties.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: it is common to carve out fraud.

Is warranty insurance common?

Frequency/market practice: rarely used, but has been used in private equity exits.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: rarely.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: Fairly common for actually received

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common for actually received.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: this is not usually express but is required by law.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: rarely.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: PRC law is mandatory for certain types of agreements (e.g., a purchase agreement of which both the seller and the buyer are Chinese entities, and joint venture contracts with Chinese entities). Otherwise, Hong Kong or English law is more common.

What is the common governing law?

Frequency/market practice: PRC law is mandatory for certain types of agreements (e.g., a purchase agreement of which both the seller and the buyer are Chinese entities, and joint venture contracts with Chinese entities). Otherwise, Hong Kong or English law is more common.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is more common. Hong Kong is predominately chosen but will typically carve out court or administrative action (e.g., injunction). Chinese arbitration (e.g., CIETAC) is becoming more accepted in the market.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: an equity/share/asset purchase agreement is subject to stamp duty in the amount of 0.05% of the purchase price (for each party). It is common for stamp duty to be equally shared.

Is a separate tax covenant / indemnity or tax deed common?

Frequency/market practice: rarely; this is becoming increasingly common.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Qatar

Common deal structures

What are the key private M&A deal structures?

In Qatar, transactions are usually concluded through either a share purchase or an asset purchase. Statutory mergers can also be concluded under Qatar law, but these are not commonly used.

Auctions are commonly conducted in Qatar. Bid process letters are commonly used and often require binding offers to be submitted, although such binding offers are usually drafted to be highly conditional and are therefore unlikely to have a binding effect.

The Companies Law provides for the merger of Qatar companies by way of amalgamation (where two companies merge by disappearing into one newly formed company) and absorption (where one company merges into another and only the merged company survives). These provisions are complex, largely untested and therefore not generally used in the context of private M&A transactions.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

Several types of corporate entities may be formed in Qatar under either the Companies Law or the Civil Code. In the context of private M&A transactions, the most common forms of company incorporated in Qatar are the limited liability company ("**LLC**") and the private joint stock company ("**PJSC**"), both formed under the Companies Law. Companies established under the Civil Code are not generally permitted to have corporate shareholders and so do not commonly feature in M&A transactions. PJSCs are subject to more onerous administrative obligations, so the LLC is the vehicle most commonly encountered.

What are the different types of limited liability companies?

The LLC structure offers limited liability to its shareholders and provides that the number of shareholders must be a minimum of one, and not more than 50.

The Companies Law lifted the requirement for a minimal capital for LLCs and instead stipulates now that, "The partners determine the capital of the company." The share capital must be made up of equal shares (meaning that different classes of shares are not permitted) and have to be fully paid up and deposited with a Qatar bank. Government regulations mean higher minimum capital requirements can be imposed on a discretionary basis with respect to certain classes of company or types of activity. Qatar's foreign ownership restrictions mean that a foreign party can only ever hold 49% or less in an LLC. Despite this, the LLC structure is flexible so that appropriate safeguards for the minority party can be included in the registered constitutive documents of the LLC (referred to as a 'contract of establishment' or the 'memorandum' and 'articles of association').

Such minority protections can include:

- supermajority voting;
- management control;
- disproportionate allocation of profits between shareholders, which does not need to reflect the shareholding percentage in the LLC. For example, a minority shareholder can receive up to 90% (or more in some cases) of the LLC's profits; and

- shareholding agreements and other contractual arrangements that supplement the memorandum and articles of association.

Additionally, Article 207 of the Companies Law allows for alternative joint venture arrangements, through which the government or a government entity in partnership with foreign investors may establish a private shareholding company. The main advantage of an Article 207 company is that the Companies Law only applies to the extent that it does not conflict with the memorandum and articles of association, joint venture agreement or other contracts of establishment. The shareholders are therefore able to draft those documents free of all or any of the restrictions contained in the Companies Law. In addition, due to a recent amendment in the law, the foreign investor's share ownership in the Article 207 company can be more than 49% with the approval of the Council of Ministers.

Is there a restriction on shareholder numbers?

There is a restriction of not more than 50 shareholders for LLCs.

What are the key features of a share sale and purchase?

A share purchase in Qatar will share many commonalities with share purchases in other jurisdictions. The key transactional document will be the share purchase agreement. A share purchase agreement ("**SPA**") is typically signed by the relevant parties to the acquisition of shares. An SPA can be drafted in English, does not have to be notarized and the parties can sign the signature page without having to sign or initial each page of the SPA. The Qatar law on the protection of competition and prohibition of monopolistic practices (19 of 2006) prescribes a mandatory notification if the relevant market threshold test is met. This will normally be included as a condition to a transaction. Other documents such as a disclosure letter, transition service agreement or shareholders agreements will be similar to those used in other jurisdictions.

The precise share transfer mechanics vary quite widely between the different company types and often mean that an escrow is used to hold the consideration payment. Generally, a short form bilingual sale and purchase agreement is concluded before the Ministry of Justice.

Qatar has recently introduced Law No. 1 of 2020 (the "**Unified Economic Register Law"**). The Unified Economic Register Law requires the Ministry of Commerce and Industry to establish a unified economic registry with the aim of creating a state level register of beneficial ownership. The Unified Economic Register Law's Executive Regulations comes into force on 12 June 2020. The Unified Economic Register Law will likely impact the filings required in any share sale and purchase transaction.

What are the key features of an asset sale and purchase?

An asset purchase in Qatar will share many commonalities with asset purchases in other jurisdictions. The key transactional document will be the asset purchase agreement. This document does not need to be submitted to any authorities and can therefore be drafted in the language preferred by the parties. Unless the assets to be transferred are of a type that are registered (e.g., registered trademarks, motor vehicles, real estate, etc.), there is no need to file any documentation with the relevant authorities. In the event that registered assets are to be transferred, the parties would typically execute a short-form document to that effect rather than filing the long-form asset purchase agreement that contains the full terms of the transaction with the authorities.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

Yes, it is customary to prepare a letter of intent or term sheet. These are usually non-binding documents with the exception of some clauses, such as exclusivity, confidentiality and others.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: Exclusivity provisions are very common provisions in term sheets.
- Break fee: Break fees are not common in Qatar transactions.
- Confidentiality: Confidentiality provisions are very common provisions in term sheets.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Exclusivity, break fee(s) and confidentiality provisions can be either dealt with in separate agreements or wrapped together in a term sheet. There is no specific legal reason for this; it is usually a question of timing.

Is there a duty or obligation to negotiate in good faith?

The Civil Code provides that a party may terminate a contract if the other party makes a misrepresentation and the contract has been entered into by a 'gross cheat.' The Civil Code further provides that deliberate silence concerning a fact or circumstance must be treated as a misrepresentation if it is proved that the person misled the other and thereby would not have made the contract if aware of that fact or circumstance.

Although the courts are not bound to adhere to case precedents under Qatar law, Qatari courts have provided the following indications in previous cases of how liability would be determined:

- it is necessary to prove that there has been both a 'misrepresentation' and a 'gross cheat';
- the criterion for determining whether there has been a 'gross cheat' depends on the factual circumstances and the discretion of the court;
- in determining whether there has been a 'gross cheat,' there must be a serious discrepancy between the true value of the thing sold and the price for which the buyer is buying it, to the extent that the victim would not have entered into the contract if the 'gross cheat' had not occurred; and
- the burden of proving that there has been a 'gross cheat' lies with the party making that allegation.

Depending on the facts, it is possible that the provisions set out above could be used to imply an obligation to disclose material information even where the seller has not specifically been asked to disclose that information in the due diligence process. However, it is recommended that buyers do not rely solely on this provision, and try to make the due diligence questionnaire process as comprehensive as possible. Sellers should be wary of this provision and note the risk that there may be liability issues if relevant.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: purchase price adjustments are common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: we see all types, including working capital adjustment, cash-free debt-free, and NAV adjustments. We also see locked box arrangements.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: it depends on the negotiating strength of the respective parties, but it is more commonly the buyer.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely, although sometimes on medium size and large deals.

Is an earn-out common?

Frequency/market practice: earn-outs are not historically common, but have become more common in the past few years.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: an escrow is fairly common as a completion mechanism to ensure that payment is made at completion.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: rarely; typically resisted by sellers. This is only available where there is a long period between signing and completion and is limited to very specific events.

Is the MAE general or specific?

Frequency/market practice: both are seen.

Is the MAE quantified?

Frequency/market practice: rarely.

Covenants

Is a non-compete common?

Frequency/market practice: very common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: waterfall/blue pencil provisions are fairly common, depending on the terms incorporated into the contract (for example, the jurisdiction applied to for the acquisition agreement and the incorporation of an appropriate severance provision).

Are non-solicitation provisions (of employees) common?

Frequency/market practice very common (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: very common (in conjunction with a non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: very common for private deals.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: very common; updating schedules is common. Notification of possible breach is common. Where there is a material breach, there is a right to terminate.

Representations and warranties

Materiality in representations - how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen but often not quantified (other than specific warranties, e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge is often qualified (frequently by reference to a specific group).

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common; this is still commonly requested by buyers, but often resisted by sellers.

Is disclosure of the data room common?

Frequency/market practice: fairly common.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common; this is highly dependent on the strength of the respective parties' bargaining position but if permitted, it is common to only repeat at closing with no bring-down certificate.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: fairly common.

Is a bring-down certificate at closing common?

Frequency/market practice: rarely.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate in all material respects is common but often carve out for fundamental representations which must be absolutely true.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: commonly 20%-50%, sometimes higher if the situation permits.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: these usually just apply to warranties only. Sometimes the limitations will also apply to indemnities, but this is less common.

What are the common exceptions to the cap?

Frequency/market practice: key warranties are often excepted (e.g., title, capitalization, authority). Often, tax and specific areas of concern are excepted, or sometimes have specific higher caps. Separate caps can be negotiated.

Is a deductible or basket common?

Frequency/market practice: both are fairly common.

Is a *de minimis* common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: it survives for 12-36 months (usually at least one full audit cycle under the buyer's ownership) for general representations and warranties except for tax (if applicable), fundamental warranties/specific indemnities.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: it is common to carve out fraud and misrepresentation. Fundamental warranties are often carved out as well, depending on the circumstances and the liability cap agreed. The liability period for tax warranties is typically longer than the liability period for general warranties.

Is warranty insurance common?

Frequency/market practice: rarely; this is very new and untested in the Qatar market.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: this is rare due to the lack of taxes levied in Qatar (except corporate tax on foreign investment).

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: common for insurance proceeds that are actually received.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: common for insurance proceeds that are actually received.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: this is usually specifically included in the purchase agreement.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: fairly common.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: Qatar law is common (and will likely be implied) for purchase agreements between two Qatari parties. English law is commonly used for all other transactions.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration in the Qatar International Center for Arbitration or overseas jurisdictions is commonplace and recommended as awards can generally be enforced without a local court rehearing the case.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: no stamp duty is payable. Notarization fees for the transfer of shares in a limited liability company are paid by each party.

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: tax indemnities and warranties are becoming increasingly used in Qatar. They are usually included in the SPA and are relatively short form in comparison to other jurisdictions.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Russia

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

Most target companies in Russia carry historic title, regulatory, compliance and/or tax risks; however, experienced sellers will attempt to clean-up historic issues when preparing for a sale. It is important to identify these risks, assess their impact on the target and its value, and decide whether they may be mitigated through transaction structuring. A careful due diligence exercise in many instances is critical because it enables the buyer to adjust the purchase price in line with the risks or walk away from the deal, rather than rely on recovering damages from the seller(s) after closing and following lengthy court battles. Important information relevant for due diligence is often not publicly available and should be requested from the target or the sellers.

Companies often have complex ownership structures, such as multiple layers of holding companies, offshore holdings, as well as non-transparent beneficiaries. Careful attention should be paid to financial due diligence, making sure no hidden liabilities are missed, and tax due diligence — violations of tax legislation is a widespread risk in relation to Russian companies. Due diligence focus should also take into account industry specifics. By way of example, reviewing subsoil licenses is key in the due diligence of a mining or upstream oil and gas business. In healthcare or IT sectors, IP expertize is important to efficiently identify possible risks and confirm title to core assets.

Some of the other most common areas of review include anti-bribery and sanctions compliance, regulatory (relevant legislation may be very extensive and complex), employment, and environmental issues. In Russia, due diligence does not normally trigger obligations to report uncovered issues to regulators.

Based on due diligence findings, in order to address identified risks, parties may negotiate special closing conditions, include specific representations on facts and indemnification obligations of the seller(s), and envisage deferred payments or other security mechanisms (e.g., personal or corporate guarantees) protecting the buyer.

Independent appraisal

As a general rule, there is no need for independent appraisal in an asset or a share deal. Specific instances where independent appraisal is required are provided by Russian law (e.g., in privatization deals, or appraisal of a non-cash contribution made by an investor, or a charter capital increase).

Payment

As a general rule, all transactions between Russian entities must be settled in rubles (although agreements may refer to the ruble value equivalent of a foreign currency). Various currency control requirements and limitations apply to Russian residents. No substantive currency control requirements (in the form of consents, authorizations, permits, etc.) apply to foreign transactions. Transactions between residents and non-residents (foreign buyers and sellers) involving payments in rubles and foreign currency can be generally concluded subject to compliance with certain procedural requirements by Russian residents.

Signing/closing

Share sale

Whether signing and closing is simultaneous or non-simultaneous depends on whether there are conditions that must be satisfied before closing, including regulatory approvals (e.g., merger control, foreign investments in strategic companies), and the need to carry out pre-closing restructuring or to obtain third-party consents or waivers.

Asset sale

The timing of signing and closing an assets sale also depends on any conditions that must be satisfied before closing (including regulatory approvals), as well as on the timing required for the buyer to obtain all permits/licenses that may be required to own and operate the purchased assets.

Approvals/registrations

Foreign investment

The preliminary consent of a special governmental commission is required for foreign investment in companies doing business in certain sectors of the Russian economy ("strategic companies"), i.e., nuclear industry, weapons and the military equipment industry, aviation and aviation security, space activities, manufacture of special equipment (e.g., connected with encryption), geological surveys, exploration and development of natural resources, modification of hydro-meteorological and geophysical processes and phenomena, mass media and certain types of telecommunications services rendered by business entities having a dominant position in the relevant markets.

Additional restrictions apply to foreign investment in strategic companies involved in the exploration, development and production of natural resources on subsoil plots of federal significance.

The prior consent of a special governmental commission is required for transactions resulting in:

- foreign investors' acquisition of control over a Russian strategic company (by holding voting shares, having the right to appoint a majority of its management/executive bodies, performing the functions of its management company or otherwise determining the decisions of a company)
- the acquisition by a foreign country, international organization, and companies under their control, including Russian companies, of more than 25% of the voting shares or rights to block decisions of the management bodies of a strategic company

The law permits the above transactions to be effected without prior consent if, before the transaction, the acquiring foreign investor directly or indirectly held more than 50% of the voting shares in the strategic company. However, this exemption is not applicable to strategic companies using federal subsoil plots. Certain other transactions involving strategic companies using federal subsoil plots are in the scope of governmental control.

The law also covers a foreign investor's acquisition of the main production assets of a strategic company whose value is 25% or more of the book asset value of the company.

The Russian antitrust regulator (the Federal Antimonopoly Service or "**FAS**") must be informed about the completion of transactions and other actions for which preliminary consent was obtained.

Investments of foreign states, international organizations and organizations under their control into Russian companies (strategic and non-strategic) are subject to additional clearance requirements under the Russian Law on Foreign Investments. Any transaction that gives a foreign state, an international organization or an organization under their control the right to dispose, directly or indirectly, of more than 25% of the total number of votes attached to voting shares in any Russian company, or otherwise block decisions of the governing bodies of a Russian company, requires preliminary clearance with the Russian government and/or FAS.

In addition, any transactions of a foreign investor with respect to a Russian company may require prior approval from the governmental commission if the chair of the governmental commission (i.e. the Prime Minister) decides that such transaction may threaten national defence and state security in a broad sense.

Merger control

Share sale

Prior approval from FAS is required for the acquisition of shares in a Russian company if, as a result, the acquirer will hold more than 25%, 50% or 75% of the shares in a Russian joint-stock company ("**JSC**"), or more than one-third, 50% or two-thirds of the participatory interests in a limited liability company ("**LLC**"), as long as:

- the latest aggregate balance sheet value of the total assets of the acquirer and its "group of persons" as well as the target company and its "group of persons" exceeds RUB 7 billion and at the same time the balance sheet value of the total assets of the target company and its "group of persons" exceeds RUB 400 million; or
- the aggregate revenue earned by the acquirer and its "group of persons," together with the target company and its "group of persons," from the sale of goods (services) during the past calendar year exceeded RUB 10 billion and at the same time the balance sheet value of the total assets of the target company and its "group of persons" exceeds RUB 400 million.

When an individual, legal entity or "group of persons" acquires more than 50% of the voting shares of, or any right of control over, a legal entity incorporated outside of Russia which has a Russian subsidiary or has made sales to the Russian market during the previous calendar year in an amount exceeding RUB 1 billion, or the right to perform the functions of its executive bodies, the acquirer must receive prior approval from FAS if:

- the aggregate book value of the assets of the acquirer and its "group of persons" plus the target and its "group of persons" exceeds RUB 7 billion and the balance sheet value of the total assets of the target and its group exceeds RUB 400 million; or
- the aggregate revenue earned by the acquirer and its "group of persons" plus the target and its "group of persons" from the sale of goods over the past calendar year exceeds RUB 10 billion and the balance sheet value of the total assets of the target and its group exceeds RUB 400 million.

In determining the threshold for asset and revenue values, FAS takes into consideration not only the acquirer and the target company, but also all persons (individuals or legal entities) in the acquirer's and target's 'group of persons.'

The Competition Law contains separate conditions and thresholds for the acquisition of an interest, asset or right in a financial organization subject to pre-acquisition FAS notification; these acquisitions should be considered on a case-by-case basis.

Asset sale

Prior approval by FAS is required in an asset acquisition if the acquirer (or its "group of persons") acquires assets (or the right to use assets) exceeding 20% of the balance sheet value of the fixed production and/or intangible assets of the Russian target company, as long as:

- the latest aggregate balance sheet value of the total assets of the acquirer and its "group of persons," as well as the target company and its "group of persons," exceeds RUB 7 billion and at the same time the balance sheet value of the total assets of the target company and its "group of persons" exceeds RUB 400 million; or
- the aggregate revenue earned by the acquirer and its "group of persons," together with the target company and its "group of persons," from the sale of goods (services) during the past calendar year exceeded RUB 10 billion and at the same time the balance sheet value of the total assets of the target company and its "group of persons" exceeds RUB 400 million.

Separate filing requirements apply for a merger of Russian commercial organizations (prior approval by FAS is required as long as the latest aggregate balance sheet value of their assets (or the assets of their "group of persons") exceeds RUB 7 billion, or the aggregate revenue earned by these organizations (or their "group of persons") from the sale of goods (services) during the past calendar year exceeded RUB 10 billion).

Moreover, "agreements on joint activities" concluded between competing entities in or outside Russia, targeted to the Russian market, require prior approval from FAS if the latest aggregate balance sheet value of the assets of the parties (or the assets of their "group of persons") exceeds RUB 7 billion, or the aggregate revenue earned by these organizations (or their "group of persons") from the sale of goods (services) during the past calendar year exceeded RUB 10 billion. Shareholders' agreements that may be entered into in the context of an M&A deal may often fall under this category, and thus require FAS approval before execution.

Other regulatory or government approvals

Rules may vary depending on the specific sector or industry and, in certain instances, approval by the relevant industry regulator may be required and certain restrictions for foreign investments may apply. For example, the total share of foreign investment in the charter capital of all banks in the Russian banking system may not exceed 50%. Non-residents need prior approval from the Bank of Russia to acquire 10% or more of the shares in a Russian bank or non-banking credit organization, etc. Certain restrictions also apply in the mass media, insurance, natural resources and certain other industries as well as in the area of export/import control.

Employment

Share sale

A share acquisition does not affect the employment relations between the employees and the target company, since:

- the employer remains the same;
- there is no need to enter into any addenda to existing employment agreements with employees;
- a share acquisition is not a ground to change employees' employment terms and conditions; and
- a share acquisition is not a ground to dismiss any employees (including top management).

Asset sale

An asset acquisition does not entail the automatic transfer of employees by operation of law. The buyer may select which employees of the target company it is willing to employ.

Employee transfer

In the context of an asset sale, a transfer of employees requires the employees' consent and may only be formalized by complete termination of employment with the seller and hiring by the buyer.

Employee termination by the seller may be formalized under the following options:

- voluntary resignation;
- termination by mutual agreement; or
- termination as a result of the employees' consent to transfer to another employer.

Formally, these three options constitute three different grounds for termination of employment; however, the differences between them are not substantive in practice. Most companies prefer to use the third option because it is generally favored by employees and may therefore allow for a smoother transfer process. If an employee objects and does not give consent to the transfer to the buyer, the employee remains employed by the seller and may be terminated in compliance with Russian labor legislation (e.g., due to staff redundancy). No formal notifications to employees or consultations are required, unless otherwise provided in the current employer's internal local policies, a collective bargaining agreement or an employment agreement. Therefore, the transfer of employees may be completed without significant delays if the process is well organized.

Terms and conditions of employment with the buyer

Russian law does not require that the terms of employment of the transferred employees with the buyer mirror those with the seller. The practical approach here is that the employees should be motivated to agree to the transfer under the proposed employment conditions with the buyer.

Additionally, as a result of the transfer, employees may not carry over any accrued benefits/guarantees existing at the seller to the buyer (e.g., accrued vacation days), since the buyer will not be considered the legal successor of the seller in employment relations. This rule cannot be changed — even by agreement between the seller and the buyer.

Foreign employees

In transfers involving foreign employees, any Russian immigration issues should be resolved before the transfer, i.e., all required migration documents should be obtained before foreign nationals can commence work at the buyer.

Tax

Share sale

In a share sale, the tax liabilities of the acquired company remain with the acquired company. Therefore, pre-acquisition tax due diligence is important. The buyer is not subject to Russian corporate profits tax on the purchase of shares. The buyer may not depreciate or otherwise deduct the acquisition price paid for shares, unless it subsequently sells or otherwise disposes of the shares. The buyer also does not get a step-up in basis of the underlying assets of the purchased target company.

Accumulated tax losses remain with the target company and can be carried forward and used after the share deal. No tax loss carryback applies.

When a domestic seller sells the shares in a Russian company, realized capital gains are subject to Russian corporate profits tax at a standard 20% rate. There is a capital gains exemption for shares which are not publicly traded in a Russian company, held by a Russian seller over five years, or shares in companies in the high-tech (innovation) sector, held by a Russian seller over one year.

When a foreign seller sells the shares in a Russian company, the 20% Russian withholding tax applies if more than 50% of the underlying assets -directly or indirectly- consists of immovable property located in Russia and subject to provisions under a relevant double tax treaty.

The Russian corporate profits tax payable is in the hands of the domestic seller; the domestic buyer may be subject to subsidiary liability in certain situations (i.e. if the domestic seller does not settle its tax obligations and goes into bankruptcy or the seller and the buyer are related persons). Currently, there is no mechanism to impose subsidiary liability on a foreign buyer.

Transfers of shares are exempt from Russian VAT, unless the Russian tax authorities re-characterize the transfer into an asset sale. No transfer taxes apply to the sale of shares in Russia. However, there are notary fees for certification of the share and purchase agreement on shares in a Russian limited liability company by a Russian notary, and registrar fees associated with the transfer of title to shares in a joint-stock company.

Asset sale

There is no transfer of tax liabilities in asset deals in Russia. In an asset deal, tangible and intangible assets can be sold. However, the concept of goodwill is very limited under Russian law. Goodwill is recognized only in a transfer of an enterprise as a property complex; goodwill cannot be transferred under a regular asset sale. Other intangible assets can be transferred as a part of an asset sale if they are recognized as assets under local laws and are found in the accounting books of the Russian seller prior to the deal. For example, customer lists and other types of intangible assets common in other countries are often not initially accounted for by the Russian seller, and inventory-reconciliation of intangible assets is required prior to an asset deal.

An asset deal allows the company acquiring assets to have a step-up in basis, as the assets will be recognized for tax purposes at the acquisition price. Depending on the type of the asset, the company acquiring assets may depreciate (amortize) the value of the asset on that acquisition price or deduct for Russian corporate profits tax purposes.

In an acquisition of all of a target company's assets, the asset deal may be recognized as an acquisition of an enterprise as a property complex and will be subject to state registration. The excess of the acquisition price over the net asset value of the enterprise will be recognized as goodwill, subject to straight-line depreciation over a five-year period for tax purposes. The excess of the net asset value of the enterprise over the acquisition price will be recognized as an income of the buyer, subject to 20% Russian corporate profits tax at the time of state registration.

Accumulated tax losses are not transferred under an asset deal.

In an asset sale, the Russian seller is subject to 20% Russian corporate profits tax. The tax book value of the assets, e.g., residual value, is recognized as the cost reducing the tax base. A foreign corporate seller is subject to 20% Russian withholding tax only on the sale of real estate situated in Russia (the provisions of a relevant double tax treaty may apply).

Generally, the sale of assets in Russian territory is subject to Russian VAT at a rate of 20% (subject to some exceptions: transfer of land, IP rights on knowhow, patents, software use, etc.). Under an asset deal, the VAT is included in the purchase price for the assets. Therefore, while the seller pays VAT to the budget and submits all tax returns with regard to VAT, the buyer bears the economic burden of the VAT. The VAT paid in the purchase of the assets can be offset against VAT liabilities of the buyer. No stamp duty applies, except for state duties and registration fees. State duty applies to the registration of rights to real estate, registration fees for the transfer of cars and other vehicles. State duties also apply to the registration of an enterprise as a property complex, the registration of an agreement for the sale of an enterprise as a property complex, etc.

Post-acquisition integration

It is critical to plan for post-acquisition integration well in advance of closing, particularly when specific registrations are required for the operation of a business. Obtaining or transferring these registrations can be time consuming and the parties may need to agree on the way the business will be operated during the period that the registrations are pending. Various accounting and taxation issues shall also be taken into account when planning the post-acquisition integration. In addition, when planning the implementation of a merger, it is important to be aware that it is highly likely a tax audit will be performed by tax authorities in connection with the merger process.

Common deal structures

What are the key private M&A deal structures?

In private deals, the acquisition of a business in Russia is usually achieved through the purchase of shares or assets. Corporate reorganizations (such as mergers and consolidations) between Russian companies are less common because they take several months to implement, require the involvement of creditors and trigger a tax audit. In a merger, two or more companies merge into one existing company. In a consolidation, two or more companies consolidate into a new company. Russian law allows mergers/consolidations involving both joint-stock and limited liability companies, but does not allow foreign entities to merge with local companies.

There is no direct equivalent of a scheme of arrangement in Russian law, but in the case of insolvent debtors, their business or assets may be sold as part of court-controlled insolvency procedures.

Auction processes are relatively common in private acquisitions involving sophisticated sellers, and it is common to use indicative bid letters that are non-binding.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

Historically, many Russian companies were owned by foreign holdings with nominee directors/shareholders who hold shares in trust for Russian UBOs. Due to recent changes in tax laws and Western sanctions, there is a tendency to abandon obscure foreign ownership structures. It is not uncommon for sellers to propose to sell holding companies. However, buyers often prefer to buy shares directly in Russian companies, rather than take the risk of acquiring offshore holdings.

There are several types of commercial legal entities in Russia. The two types of entities most commonly used for business operations in Russia are limited liability companies and non-public joint-stock companies. Other corporate forms such as various types of partnerships, etc. are used much less frequently.

What are the different types of limited liability companies?

There is only one type of limited liability company, and in practice, an LLC is often a preferred choice for a corporate structure in Russia, particularly for wholly owned entities. This choice is influenced mainly by: (i) more complicated procedures for the incorporation and financing of a JSC through charter capital increases, as the issuance of JSC shares requires their registration with the securities market regulator, resulting in various timing and regulatory issues; and (ii) stricter reporting requirements applicable to JSCs and higher corporate maintenance costs (e.g., a registrar's fees for the transfer of title with respect to shares in a JSC are generally higher than the fees of a local notary who, under Russian law, certifies transfers of participation interests in an LLC). Title to participation interests in the LLC is recorded in the companies' register maintained by tax authorities and information about shareholders (participants) and their ownership shares in the LLC is publicly available. In JSCs, title is recorded in the shareholders' register maintained by a specialized registrar and information about shareholders in JSCs is not publicly available (with the exception of the initial founder/s who is/are shown in the companies' register).

Is there a restriction on shareholder numbers?

The charter capital of an LLC is divided into participation interests held by participants in the LLC. The number of participants in an LLC may not exceed 50.

A single founder, whether Russian or non-Russian, may establish an LLC or a JSC but only if it is not itself a company owned by a single individual or entity (the so-called "1-1-1 shareholding structure restriction").

What are the key features of a share sale and purchase?

Shares in a JSC exist in non-documentary form as entries on a shareholder's account in a shareholders' register maintained by a professional third-party registrar or in a specialized depository. There are two classes of shares: ordinary (voting) shares and preference shares, which are normally non-voting but may become voting in certain circumstances. Shares in JSCs under Russian law are classified as securities and each share issue must be registered with the Central Bank of Russia. Title to a share passes when the relevant entry is made in the shareholders' register (or depository) to reflect that the share is recorded on the personal account of the buyer.

Participation interests in an LLC are not classified as securities and do not need to be registered with the Central Bank. The LLC is obliged to maintain a list of its participants specifying their shareholdings. Participants in the LLC and title to their shareholdings are recorded in the Russian companies' register, which is maintained by the tax authorities and is publicly available. Title to a participation interest passes when the relevant transfer is recorded in the companies' register. A sale and purchase agreement must be notarized by a Russian notary in order to be valid.

As with shares in the JSC, a participation interest in an LLC may be transferred only after it has been fully paid up by the founders (or by the shareholders upon the charter capital increase).

What are the key features of an asset sale and purchase?

Under the Civil Code, an asset transaction may be made in the form of either an ordinary asset sale (asset sale) or the sale of an enterprise (enterprise sale).

An ordinary asset sale enables the buyer to acquire specific assets without liabilities, which generally stay with the previous owner.

An enterprise sale is a sale whereby the seller transfers an enterprise as a whole to the buyer, which includes all types of property required for its commercial activities. This includes land, buildings, facilities, equipment, tools, raw materials, inventory, claims (receivables) and debts (payables), as well as the company's name, trademarks, service marks and other exclusive rights, unless otherwise provided by statute or contract. The contract for an enterprise sale must generally be concluded in the form of a single document.

Under Russian law, an enterprise is treated as immovable property. Title to the enterprise property passes to the buyer upon registration of the transfer with the Unified State Register of Real Estate. However, due to a rather complicated procedure for ascertaining whether a property complex is an enterprise and for registering it, the sale of an enterprise is rarely used in M&A deals.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

It is customary to prepare a letter of intent and make it non-binding. To be legally binding in a Russian-law-governed transaction, a letter of intent must be a "preliminary agreement" and must conform with the requirements of the Civil Code of the Russian Federation, that is, it must be in the form required for the acquisition agreement (usually in simple written form). Preliminary agreements on the sale of shares (participation interests) in limited liability companies must be executed before a Russian notary to be legally binding.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: exclusivity provisions are common in a term sheet;
- Break fee: Break fees are not very common, but are occasionally included.
- Confidentiality: it is customary to include confidentiality provisions in a term sheet.

Are provisions in a term sheet detailing exclusivity, break fee(s) and confidentiality usually supplemented with separately negotiated agreements? If not, why not?

It is common to enter into a separate confidentiality agreement prior to starting negotiations on a term sheet or prior to provision of due diligence information and documents. It is less common to have separate exclusivity or break-fee agreements.

Is there a duty or obligation to negotiate in good faith?

When negotiating and entering into a contract under Russian law, the parties must act in good faith, which includes an obligation to provide accurate and complete information as required by law or regarding the substance of the negotiated transaction. If a party suffers due to the other party acting in bad faith, it may claim for compensation of damages from the offending party.

Agreeing to the acquisition agreement

Purpose price

Is a purchase price adjustment common?

Frequency/market practice: purchase price adjustments are common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: all types of purchase price adjustments are seen, including working capital adjustment, cash-free debt-free and NAV adjustments.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually prepared by the buyer.

Is the balance sheet audited (where applicable)?

Frequency/market practice: fairly common.

Is an earn-out common?

Frequency/market practice: earn-outs are common in transactions when the sellers continue to manage the target company after closing.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: an escrow is common as a completion mechanic in order to ensure that payment is made at completion.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common.

Is the MAE general or specific?

Frequency/market practice: specific is more common.

Is the MAE quantified?

Frequency/market practice: fairly common.

Covenants

Is a non-compete common?

Frequency/market practice: a non-compete is common, similar to the United Kingdom, but under Russian law non-competes are generally unenforceable, and it is common to use a non-compete event as a trigger for a call/put option.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: blue pencil provisions are fairly common. Waterfall is occasionally used.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: common (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: occasionally met (in conjunction with a non-compete), but must be analysed from an anti-trust perspective.

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: common for private deals.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: updating is common. Notification of possible breach is common. In cases of material breach, there is a right to terminate.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: materiality qualifiers are common with reference to a specific amount (contract value, etc.).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are growing, often limited to the actual knowledge and knowledge of specified members of senior management.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common.

Is disclosure of the data room common?

Frequency/market practice: very common.

Repetition of representations and warranties

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: repetition at completion is very common.

Is a bring-down certificate at closing common?

Frequency/market practice: a bring-down certificate is fairly common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate in all material respects is common but often carve-out for fundamental representations which must be absolutely true.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: commonly at 100%. Mid-cap and larger deals see lower caps, e.g., 20%–50%.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: they usually apply to the whole agreement.

What are the common exceptions to the cap?

Frequency/market practice: title warranties, any off-balance sheet obligation or liability of the target company, as well as specific areas of concern (e.g. tax), are sometimes given with specific higher caps. Separate caps can be negotiated.

Is a deductible or basket common?

Frequency/market practice: a deductible is more often resisted and a tipping basket more common.

Is a de minimis common?

Frequency/market practice: very common.

How long does seller liability survive?

Frequency/market practice: it survives for 12–36 months. Extended time limits (e.g., 36-56 months) may be used for tax claims.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: it is common to carve out fraud.

Is warranty insurance common?

Frequency/market practice: rarely.

Reliance

Do financiers seek to rely on buyer due diligence reports?

Frequency/market practice: fairly common.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: common for actually received.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: common for actually received.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: common.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: occasionally met, but buyer's knowledge matters.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: English law is common for large deals, although Russian law is increasingly being used, especially in deals with major state-owned companies.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is common for larger deals. Due to recent changes in Russian law, corporate disputes in relation to Russian companies may be referred to arbitral institutions meeting certain requirements (including accreditation with Russian authorities). As a result of these changes, a foreign investor intending to set up a JV with its Russian partner may consider establishing a JV company outside of Russia ("**JV Company**"), which will own 100% of the shares in a Russian operating company. Such option enables all JV corporate issues to be resolved at the level of the JV Company and will therefore avoid application of the above-mentioned new Russian rules on the resolution of corporate disputes.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: there is no stamp duty.

Is a separate tax covenant / indemnity or tax deed common?

Frequency/market practice: a separate tax deed is not very common. It is more common to include an indemnity in the purchase agreement.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Singapore

Quick reference guide

Due diligence, pricing and closing

Due diligence

Due diligence investigations remain an essential tool for assessing and reducing the risks inherent in a merger or acquisition transaction in Singapore. In the absence of complete knowledge of the operations, the scope of the assets and the extent of the liabilities of the target, due diligence investigations give the prospective buyer an opportunity to assess the legal and financial state of affairs of the target. Due diligence also facilitates effective deal structuring and it is a vital part of most mergers and acquisitions in Singapore.

Pricing and payment

There are no legal requirements to carry out a valuation or follow a particular valuation model for determining the purchase price for companies or assets in Singapore. In practice, commonly used valuation methods include net asset value ("**NAV**") and using a debt-free, cash-free basis (representing the enterprise value of the business). Purchase price adjustments are common, based on any shortfall or excess of the target's actual working capital against a target working capital. All types are seen, including working capital adjustment, cash-free, debt-free, NAV adjustments. In addition, more sellers (particularly in private equity transactions and/or auction sales) seek 'locked box' accounts to avoid post-completion adjustments.

No exchange control approvals are required for inward investment into Singapore, for the remittance of dividends or profits, or for the repatriation of capital.

Signing/closing considerations

Is a deposit required?

The payment of deposits is not common practice in Singapore except in the real estate sector.

Is simultaneous signing/closing common?

Signing and closing may occur simultaneously in Singapore. However, where it is necessary to obtain regulatory or other approvals before closing or for the buyer to complete further due diligence after signing the agreement, then a split signing and closing will occur, which is also common in Singapore.

Approvals/registrations

Foreign investment

The Singapore government actively encourages investment by foreign business interests and foreign investment restrictions are not common in Singapore. Generally, there are no restrictions on levels of foreign ownership of Singapore companies. However, ownership of companies engaged in businesses in certain industries is regulated and prior regulatory approval may be required in respect of any investment in or transfer of ownership of companies in those industries.

There are also substantial restrictions on the transfer of residential property in Singapore. Transfers of residential property to foreign persons are, subject to certain exceptions, prohibited and void. A Singapore incorporated company with a director or shareholder that is not a Singapore citizen would be deemed a foreign person for these purposes.

Merger control (antitrust/competition approval)

The Competition Act (Chapter 50B) (Competition Act) is the main legislation of general application which regulates anti-competitive behaviour in Singapore. Mergers which substantially lessen competition are prohibited under section 54 of the Competition Act (Section 54 Prohibition). The Competition and Consumer Commission of Singapore ("**CCCS**") is the regulator responsible for administering and enforcing competition laws.

Mergers, share and asset (including goodwill) acquisitions, minority stake acquisitions, establishment of joint ventures and other conduct can constitute a merger.

The merger notification is a voluntary process. However, the CCCS retains the right to review atransaction of its own motion and can request that the parties submit a merger notification if the CCCS considers there is a risk that the transaction will lead to a "substantial lessening of competition".

Other regulatory or government approvals

For certain sectors, consent from the relevant industry regulator may be necessary, depending on the nature of the target's business. The Section 54 Prohibition does not apply to mergers that are approved by the Minister, the Monetary Authority of Singapore or other regulatory authority. Similarly, the Section 54 Prohibition does not apply to mergers that are under the jurisdiction of other regulatory authority under any written law relating to competition - examples include telecommunications services, and media services.

In some sectors, however, a change of control or transfer of assets may merely require notification to the relevant authorities rather than an obligation to obtain consent.

Employment

Where a transaction takes the form of an acquisition of shares in a company with employees, there are unlikely to be significant employment law issues, as the underlying employment contract (and employee benefits generally) between the target and its employees will usually be unaffected by the change in control. The contracts of key senior personnel should be checked for any change of control provisions. Due diligence should be undertaken to ensure that potential liability for past acts and omissions is known.

In a business sale scenario, or in a restructuring involving a merger, take-over, sale of parts of the company or setting up a subsidiary company, the employees of the transferor may be transferred to a related company such as a subsidiary, or to a totally unrelated company by operation of law.

The Ministry of Manpower ("**MOM**") has issued guidance to exclude application of the automatic transfer from the following scenarios:

- transfer of assets only;
- transfer of shares;
- transfer of operations outside Singapore; or
- outsourcing of supporting functions.

Unless the employee agrees to changes in the terms, the transferring employee's terms or conditions of employment will remain the same and the transferee employer will take over the transferring employee's contract of service on the existing terms.

The transferring employee has the right to:

– be notified of the transfer and of matters relating to the transfer.

– be given the opportunity to consult their employer.

– preserve the original terms and conditions of employment under the new employer.

The transferor will be required to:

– notify the affected employees or their union of the impending transfer within a reasonable time.

– inform affected employees about the terms of transfer, so that they or their union can hold consultations with the company.

– ensure that there is no break in employment during the transfer.

– ensure terms of employment are not less favorable after the transfer.

For the transfer of foreign employees holding work passes, arrangements will have to be made to notify, or make new applications, and/or cancel such work passes with the MOM (as the case may be). The buyer should also ensure that it is permitted within its quota to hire any foreign employees on certain categories of work passes.

If the seller employs at least 10 employees in businesses registered in Singapore and intends to retrench five or more of these employees within any six-month period, it will need to make a mandatory retrenchment notification to the MOM.

Tax

Singapore stamp duty is chargeable on the mortgage of Singapore immovable property and stock or shares, or any transfer of any interest in Singapore immovable properties (including leases) and shares in Singapore companies or companies which maintain a share register in Singapore (Stampable Property).

For a transfer of shares in Singapore companies or in companies which maintain a share register in Singapore, stamp duty is payable at the rate of 0.2% on the higher of (a) the consideration paid, and (b) the open market value of the shares. For non-listed companies, where the open market value is not available, as an administrative practice, the Inland Revenue Authority of Singapore ("**IRAS**") generally accepts the valuation of shares by reference to the net asset value of the target company.

For conveyance, assignment or transfer of non-residential real property in Singapore, buyer's stamp duty is payable at the rates of 1% on the first SGD 180,000 of the purchase price or market value of the real property (whichever is higher); 2% on the next SGD 180,000; and 3% thereafter. For residential real property, the top marginal rate of buyer's stamp duty is 4%. There may also be seller stamp duties applicable in the case of the sale or disposal of certain residential and industrial properties, depending on the holding period of the property.

In addition, to the extent that there is a transfer of interests in any entity that (i) holds any residential property in Singapore; or (ii) beneficially owns (directly or indirectly) any entity that holds residential property in Singapore, it should be considered whether the transaction may trigger additional conveyance duty.

Generally, all taxable supplies of goods and services made in Singapore by a taxable person in the course or furtherance of any business carried on by it are subject to Singapore goods and services tax ("**GST**") at the prevailing rate of 7%. Where goods are exported or when international services are supplied, such supplies may be zero-rated.

Share sales are generally exempt from GST. Asset sales that qualify as a transfer of going concern ("T**OGC**") are excluded from GST provided certain conditions are met.

Post-acquisition integration

Buyers are realizing that the real challenge when acquiring a new business starts only when the deal closes and are focusing more on how to derive value from their acquisitions. Where the existing and target businesses operate in the same or complementary fields, the acquirer almost always wants to integrate the two businesses in order to save costs and develop synergies.

If parties intend to plan for post-acquisition integration in advance of closing, parties should note that the Competition Act prohibits agreements, decisions and concerted practices that have as their object or effect the prevention, restriction or distortion of competition within Singapore and should ensure that any exchange of information between parties pre-merger (particularly on commercially sensitive information (e.g., prices and customer information)) complies with, and is not in breach of, the prohibition.

Common deal structures

What are the key private M&A deal structures?

When a business opportunity has been identified, the acquirer and the target can structure the acquisition in several ways. The acquirer may either purchase the shares in the target from its shareholders or purchase assets directly from the target. It may also consider a long-form amalgamation as a means to merge the target and its own acquisition vehicle but this remains an untested procedure in Singapore.

Accordingly, the share and asset acquisition route remain the usual forms of acquisition on an arm's length basis. Auction sales are increasingly seen in the Singapore market. Depending on the stage of the process, it is fairly common to see indicative non-binding bid letters in the early stage and binding offer letters in the later stage of the competitive sale process depending on the auction situation.

Scheme of arrangements - there is also a statutory mechanism under the Companies Act (cap. 50) ("**CA**") for a scheme of arrangement, whereby the court is empowered to make certain ancillary orders to facilitate a scheme for the purposes of reconstruction of a company, if under the scheme the whole or any part of the undertaking or property of the transferor company is to be transferred to the transferee company. This process is not commonly used in the context of an acquisition because of the procedures. In terms of process, the CA and local case law have not provided a comprehensive framework of instruction as to how schemes of arrangements are to be passed.

Statutory amalgamation — the CA outlines procedures for a form of amalgamation of companies in Singapore. Before the amendments were introduced, commercial transactions commonly referred to as a merger were, in fact, asset acquisitions. The CA allows for a more efficient statutory form of amalgamation. It provides for the amalgamation of two or more Singapore incorporated companies into a single entity that may be either one of the amalgamating companies or a new company. Note that despite the introduction of the statutory form of amalgamation, the existing forms of asset transactions known as 'mergers' will still continue to be relevant. One reason for this is that where the merger is between companies that are not in the same group, directors of the new amalgamated company may have certain reservations about making solvency statements for the combined entity. Another reason is that the amalgamation regime also creates some uncertainties that have yet to be dealt with conclusively — in particular, there are still certain accounting concerns as to how the cancellation of shares in the amalgamating companies will be accounted for, particularly if the horizontal form of amalgamation is used.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

Business in Singapore may be conducted through a variety of vehicles, including limited liability companies and partnerships. The choice of organizational form will be dictated partly by the activities that are intended to be carried on in Singapore and partly by tax considerations.

What are the different types of limited liability companies?

In Singapore, a limited liability company is a separate entity from its shareholder(s). Equity participation by Singaporeans is generally not a requirement. A foreign company can thus set up a wholly owned subsidiary in Singapore. Joint ventures may also be established using a limited liability company and indeed this is the usual structure for joint ventures in Singapore.

There is no minimum capitalization requirement. Pursuant to the Companies (Amendment) 2005 Act, shares of a company no longer require par or nominal value. Bearer shares are however still not recognized. This applies to both shares issued before and after the date of commencement of the 2005 Amendment Act.

A Singapore company must have a minimum of one director resident in Singapore. An expatriate in Singapore on an employment pass will also meet this requirement. If the requirement is not satisfied, the Accounting and Corporate Regulatory Authority and the courts may compel members of a company to appoint one director that is resident in Singapore. Members of a company may also be made liable for the debts of the company if it continues operating for more than six months without a resident director. All directors must be natural persons. Where the company has only one director, that director must not also function as the company secretary.

Is there a restriction on shareholder numbers?

A private limited company shall have at least one member and not more than 50 members, and for completeness, transfers of its shares shall be restricted (although form of restriction is not statutorily prescribed).

What are the key features of a share sale and purchase?

The sale and purchase of shares in a target company will take place between an existing shareholder and a third-party potential shareholder. A share acquisition involves a transfer of ownership only of the shares in the target. The sale and purchase will not involve the creditors of the target company unless there are pre-existing covenants with them requiring their approval for a change of control of the company. A transfer of shares in the target also transfers all of the target's assets and liabilities to the acquirer. As a legal person, the target has the capacity to incur contractual, tortious and criminal liabilities, some of which may not have been properly disclosed to the acquirer.

What are the key features of an asset sale and purchase?

Some investors may prefer to purchase specific assets in a target company as opposed to shares in the target. The purchase of assets enables them to avoid the liabilities of the company and to 'cherry pick' only the viable parts of the business. Acquirers of assets will not generally inherit the target's liabilities.

An asset acquisition requires the passing of title to assets from the target to the acquirer. The target's assets may include land and premises, stock and work-in-progress, book debts, intellectual property rights, goodwill, insurance, leases, hire purchase and other contracts, employees, shares in other entities, and plant and machinery. It will therefore be necessary to transfer each asset, or category of asset, from the target to the acquirer by way of different conveyances, assignments and transfers.

This can be rather cumbersome. In addition, a share acquisition may be necessary if the target's assets are not amenable to transfer, for example if the target has non-transferable government licenses or has entered into licensing or distribution arrangements that are not assignable.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

It is common to prepare a letter of intent or term sheet before parties enter into definitive agreements in respect of a proposed transaction. Typically, the letter of intent or term sheet will not be binding on the parties except for certain provisions such as relating to exclusivity and confidentiality.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: It is common in a typical bilateral sale to include binding exclusivity provisions in a letter of intent or term sheet even where the letter of intent/term sheet itself is not binding, although this is a commercial term that is usually subject to negotiation.
- Break fee: It is not common to use break fees in private acquisition agreements but we do see it from time to time, e.g., in a competitive auction process where the conditions precedent are the primary responsibility of the buyer.
- Confidentiality: It is very common to include binding confidentiality provisions in a letter of intent or term sheet even where the letter of intent/term sheet itself is not binding.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

If there are binding terms on confidentiality, exclusivity and break fee(s) in the term sheet then it would be very unusual to have separately negotiated agreements on these matters prior to execution of the definitive transaction documents (SPAs, etc.). To the extent any terms in the term sheet are expressed to be binding, the scope of these contractual terms should be sufficiently defined and certain to be legally enforceable and so there should be no need for additional agreements. In the case of exclusivity provisions, the exclusivity period and prohibited conduct should be set out clearly. Of course, the definitive transaction agreements may include confidentiality provisions and break fee clauses to deal with the position post-signing of the SPA in which case the prior provision in the term sheet would usually fall away.

A separate confidentiality agreement is usually negotiated as a preliminary agreement prior to the exchange of any information. Indeed this is always the case in the context of a competitive auction process where term sheets are not typical. The term sheet is far more common in a bilateral process but may well be preceded by a confidentiality agreement so that the parties can conduct discussions over a draft term sheet and document the main terms of their proposed transaction in confidence.

Is there a duty or obligation to negotiate in good faith?

Under Singapore law, pre-contractual agreements to negotiate in good faith (i.e., "lock in" agreements) are generally unenforceable, unless the agreement is to negotiate for a particular period or to use reasonable endeavors to come to an agreement as a result of the negotiations. That said, these exceptions have not been tested in Singapore courts, so parties should exercise particular caution in drafting such clauses. On the other hand, pre-contractual agreements not to enter into negotiations with any third party (i.e., "lock out" agreements) will be enforceable if there is sufficient certainty (e.g., duration).

The fact that a purchase agreement is not signed following the entry of the parties into a pre-contractual agreement, e.g., a letter of offer or term sheet, does not automatically provide a party who loses time and money any contractual recourse against the other party, unless it can be shown that the other party has breached its binding obligations under the pre-contractual agreement (in which case, the claiming party would be able to seek recourse against the defaulting party for a breach of contract).

In the case where a purchase agreement is signed, typically the parties will agree that the terms of the purchase agreement will supersede any pre-contractual agreement previously entered into by the parties in relation to the transaction. As such, if following signing the transaction does not complete, any recourse available to the parties will be determined in accordance with the terms of the signed purchase agreement.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: very common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

"Cash free/debt free coupled with normalized level of working capital" is popular for Singapore and South-east Asia deals. Locked box adjustments are also increasingly common on deals where the price payable is based on a historic set of accounts pre-signing which are diligenced by the buyer. NAV / EBITDA adjustment is rarely seen unless the target is a listed target.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely unless public companies are involved.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: the buyer usually has the responsibility of ensuring the target company prepares this, but the seller can also be responsible, especially where the seller stays on, e.g., in owner-managed companies with earn-out arrangements.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely; it is typically reviewed by the auditors but not fully audited.

Is an earn-out common?

Frequency/market practice: fairly common in tech and industrials sectors and in private equity transactions when the sellers continue to manage the target company after closing. It is less common where the seller is completely exiting. Earn-outs are commonly capped. Recommend including worked examples or illustrations of the earn-out mechanics in the purchase agreements.

Is a deposit common?

Frequency/market practice: rarely except for sale of target companies holding real-property assets (where a 10% deposit is common).

Is an escrow common?

Frequency/market practice: fairly common; escrows are commonly used by private equity investors and strategic buyers. Private equity sellers are resistant to agreeing an escrow on the basis that it will not be able to distribute any contingent element of the consideration.

Is a break fee common?

Frequency/market practice: not common. Payment for exclusivity is rare, seller more likely to require buyer to enter into a binding term sheet.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: rarely except for sale of target companies holding real-property assets where it is included either as a MAE or material damage; but seen - whether expressed as a condition or as a right to terminate - where there is a long delay between execution and completion.

Is the MAE general or specific?

Frequency/market practice: general MAEs are seen, although MAEs are more likely to be specific.

Is the MAE quantified?

Frequency/market practice: fairly common; there is a tendency to encourage clients to be more specific. It is more common for Singapore deals to have the MAE quantified (e.g. a 20% decline in revenue as compared to previous period quantified as an MAE). Quantum of threshold will depend on the industry involved, and the "lumpiness" of the target business. .

Covenants

Is a non-compete common?

Frequency/market practice: fairly common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: waterfall provisions are rarely used.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common (in conjunction with a non-compete). Common if sellers are exiting completely.

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common (in conjunction with a non-compete) Common if sellers are exiting completely.

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: fairly common, usually set out as a scheduled list of restrictions on seller preventing the target from actions adversely affecting the value of the target or having material effect on the target's business, and giving the buyer veto rights (subject to both applicable competition law and carve-outs).

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; this should generally be requested for private deals subject to common competition law compliance issues such as the sharing of confidential information prior to completion of the transaction.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: rarely, unless there is a significant gap (6 months or more) between signing and closing, although limited to matters that have arisen since signing of the purchase agreement. Notification of breach is fairly common. In the case of a material breach, buyer typically negotiates for a right to terminate in the purchase agreement.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers commonly seen but are often not quantified (other than specific warranties, e.g., contract value). Very common to see "de minimis" trigger (tipping basket) to warranty (and other contractual) claims.

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are often limited to the actual knowledge and reasonable enquiry of a specified list of members of senior management. We have seen deals involving multiple sellers where the purchase agreement separately defines the knowledge of each of the sellers.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common; this is commonly requested in the buyer's draft, and can be contentious. Rarely in competitive auction seller's draft.

Is disclosure of the data room common?

Frequency/market practice: very common.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common; repetition of all warranties at closing for all warranties is common, repetition of fundamental warranties in auctions.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: rarely.

Is a bring-down certificate at closing common?

Frequency/market practice: bring-down certificates are not very common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate in all material respects is common but often carve out for fundamental representations and representations on regulatory compliance, which must be absolutely true.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely; double materiality is usually avoided.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: 20%-50% as common for business warranties, especially on auction sales. Fundamental warranties are limited at 100%. Any leakage from Locked Box to the seller's benefit have to be reimbursed on a $-for-$ basis postclosing if identified before the typical limitation period of 3 to 12 months.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: both seen regularly although buyers resist the whole agreement.

What are the common exceptions to the cap?

Frequency/market practice: fundamental warranties are sometimes accepted (e.g., title, capitalization, authority). Often, tax and specific areas of concern are also accepted, sometimes with specific higher caps. Separate for fundamental, tax and business warranties caps can be negotiated.

Is a deductible or basket common?

Frequency/market practice: deductible is usually resisted and a tipping basket is more common.

Is a de minimis common?

Frequency/market practice: fairly common: 0.1-0.3% for individual claims and 1-3% on basket claims.

How long does seller liability survive?

Frequency/market practice: this is tied to one, and in rarer cases two, full year audit. Tax is commonly tied to the statutory limitation period (generally 4 years for Singapore income tax, and 5 years for Singapore goods and services tax, subject to exceptions). Title/capacity warranties usually have a longer period or are based on statutory limitations period (6 years for Singapore). Locked Box liability is typically limited to between 3 and 12 months.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: fraud is usually carved out. Tax is commonly longer (3 to 4 years for Singapore) than general warranties.

Is warranty insurance common?

Frequency/market practice: used in private equity exits, becoming more common. Coverage options for warranty insurance products are increasing and in some instances, can be adapted to cover specific identified risks.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common for actually received.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common for actually received.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: mitigation is required by law and buyer's draft usually exclude the application of seller's limitations on liability for Seller warranties from affecting common law rules on mitigation.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: it is fairly common to address the point as buyer's draft will often seek to exclude.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: Singapore law is generally adopted.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration in Singapore is very common but also Singapore courts, especially if contracting parties are both in Singapore.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: the Singapore Stamp Duties Act requires the buyer to bear the expense of stamp duty, unless there is an agreement to the contrary. In practice, it is also common for the buyer to bear the amount of stamp duty.

Is a separate tax covenant / indemnity or tax deed common?

Frequency/market practice: rarely. It is more common to have a tax indemnity included in the purchase agreement. Warranty insurance coverage for tax related liabilities are increasingly being used inprivate equity deals.

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Guide to Navigating Global Private M&A

Spain

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

In Spain it is common that a thorough due diligence is conducted and used as an aide to identify breaches and potential issues which are then addressed in the acquisition documents, including by means of remedies or actions to be taken before signing, between signing and closing, and post-closing.

Although areas of concern may differ depending on the type of business, environmental, privacy and compliance have become key issues to investigate. In light of the recent COVID-19 crisis, other areas may attract greater scrutiny depending on the specific business involved, such as relations with key customer and suppliers, the risk of covenant breach with respect to financing agreements or health and safety matters.

Pricing and acquisition methods

Spanish M&A practice is increasingly internationalized and Spain can now be considered a sophisticated market for M&A transactions.

Business acquisition agreements are not regulated by any specific law, and their structure and content can and will vary greatly depending on the particularities of the transaction and the covenants, agreements and undertakings of the parties to the agreement.

There are no special restrictions regarding pricing and payment in Spain from a strictly legal/corporate point of view. When the transaction is notarized in Spain (for example where a share transfer refers to bearer shares or to participation quotas in a limited liability company (*Sociedad Limitada*), or in certain transfers of assets such as real estate), the Spanish Notary Public will demand evidence of how payment of the purchase price is made (for instance, by attaching a copy of wiring instructions of a bank transfer or a copy of the bank check) as well as the identification of the parties' respective beneficial owner.

Generally, share purchases are more common than asset purchases. Other types of acquisition methods, such as mergers, may also be suitable depending on the circumstances. However, in view of the recent COVID-19 crisis and eventual changes/challenges in valuation criteria as a consequence of such crisis, it is possible that the traditional approach to the structuring and pricing of the acquisition transactions has adapted to the new circumstances.

In terms of pre-contractual obligations, the parties in an M&A negotiation are under a duty to act in good faith. Anyone in breach of that duty will be liable to compensate for direct damage caused by an unjustified breach of negotiations (normally the costs of the negotiations).

Share and asset deals may be subject to the approval of the general shareholders' meeting. The Spanish Companies Act requires that any acquisition, sale or contribution to another company of material assets must be approved by the general shareholders' meeting. The Companies Act presumes that, in any event, an asset is material when the amount of the transaction exceeds 25% of the total value of the assets in the last approved balance sheet.

Share sale

Spanish practice around share purchase agreements is familiar with standard international practice, including practices related to price determination and adjustment (cash-free debt-free/normalized working capital adjustment, NAV adjustments, locked box structures, earn-outs, etc.), conditions precedents to completion, including mandatory (such as merger control, if applicable) and voluntary conditions (such as material adverse effect conditions), interim period obligations, representations and warranties, and indemnity undertakings.

Contracts or administrative authorizations/permits/licenses may contain "change of control" provisions that trigger the need for the prior consent of the counterparty to the contract or the relevant public authority to complete the sale. Other potentially adverse effects that may arise include the right to increase the compensation payable under the contract or the right to terminate the contract in advance.

Asset sale

Although a share deal tends to be the preferred acquisition method, in certain circumstances an asset purchase has advantages that may make it more attractive to a buyer. For example, the buyer may favor an asset purchase in order to limit inheritance of liabilities to the assets acquired, rather than to the whole company (although the buyer may still be liable for certain pre-transfer liabilities for labor, tax and environmental matters).

The purchase of all of the assets of a company is regarded as a "going concern" purchase and not as the purchase of each individual asset. However, each individual asset must be transferred in accordance with the transfer formalities that apply to that type of asset. For some assets, this will simply be the delivery of the asset to the buyer. In other cases, the formalities are more prescriptive, as is the case with real property (which requires notarization and registration with the relevant public registry), in rem rights (e.g., mortgage, pledge) or intellectual property (e.g., trademarks).

Permits and licenses are not automatically assigned in transfers of going concerns, so an application for consent to assign must be made to the relevant authority. Alternatively, an application for a new license or permit will be required. In addition, contracts are not automatically assigned. However, tax and labor liabilities may be transferred as part of the asset purchase.

Signing/closing

Normally, signing and closing take place at the same time, unless closing has been made subject to the fulfilment of conditions precedent. In this case, the agreement becomes binding and enforceable on signing but the sale and purchase does not take effect until the transfer of shares/assets on closing.

It is common (and in certain cases mandatory, such as when the transfer refers to bearer shares or to participation quotas in a Spanish "Sociedad Limitada") to formalize the transfer before a Notary Public.

Approvals/registrations

Foreign investment

In general terms, foreign investments in Spain are liberalized, albeit subject to post-transaction notification to the General Directorate of Economy and Trade (*Dirección General de Comercio e Inversiones*) for statistical purposes only. The notification must comply with certain requirements and it must be executed by filing the corresponding form (forms DP-1 to D-8).

Notwithstanding the foregoing, a prior administrative authorization is required regarding transactions as a result of which investors from outside the EU and the European Free Trade Association (i) become the owner of a stake equal to, or greater than, 10 % of the share capital of a Spanish company or (ii) gain effective control or participation in the management of the company by other means, to the extent in both cases that (1) the relevant target company operates in certain key sectors or (2) the relevant investor meets certain requirements (see detail in section *Foreign Investment Restrictions* below).

In addition, certain transactions are also subject to special regulations, in particular those involving weapons or national defense-related activities (including the exploitation of minerals of strategic interest and telecommunication services), investments related to real estate for diplomatic missions by non-EU Member States, gambling, television and radio, air transportation, telecommunications, financial activities, energy, and investments from a tax haven territory.

Merger control

A transaction that fulfils the thresholds indicated below must be notified to the National Markets and Competition Commission ("**CNMC**") and it cannot be implemented until clearance from the CNMC is obtained.

Thresholds that trigger a notification are as follows (they are alternative):

1. the combined turnover of the parties in Spain is at least EUR 240 million and turnover of each of at least two parties in Spain is at least EUR 60 million; or
2. as a result of the transaction, a market share (at a domestic level or in a geographical market defined within the same) of at least 30% in any relevant market is acquired. There is an exemption to the market share threshold; even if the 30% market share is met, the transaction is not reportable if:
   (i) the target's domestic turnover does not exceed EUR 10 million; and
   (ii) the individual or combined market share is less than 50% in any relevant market.

If a transaction is reportable, there is a suspension obligation until the relevant clearance is obtained. The CNMC has one calendar month to clear transactions in Phase I (transactions that do not raise competition concerns) and two calendar months to clear transactions in Phase II (transactions that raise competition concerns). Very few transactions undergo a Phase II analysis.

Employment

Method of transfer under local law

Share sale

The mere transfer of shares is not considered a transfer of an undertaking and will not involve the transfer of employees, but simply a change in the ownership of the employer (not a change in the employer). The buyer inherits all the rights, duties and liabilities by virtue of being the new owner of the target company.

Asset sale

If a company transfers a group of assets that functions independently and that permits continuity in the business, a transfer of undertakings will occur and the affected employees will automatically transfer to the acquiring company. The transfer could entail the entire company's business or an identifiable part of it.

Mergers and spin-offs

If a company merges with another company or implements a spin-off and transfers a group of assets that function independently and that permit continuity in the business and services after the transaction, a transfer of undertakings will likely occur and the affected employees will automatically transfer to the buyer company.

Transfer of business

Acquired Rights Directive and automatic transfer of employees

If the requirements for an automatic transfer exist, the employees will automatically transfer to the transferee, who will take over the employment rights and obligations of the transferor. If those requirements are not met, each employee will need to consent to the transfer.

The transferee becomes jointly and severally liable with the transferor for a period of three years for all those obligations unsatisfied before the transfer for existing employees. Specific statutes of limitations may apply depending on the specific liability involved. If the transfer is subsequently declared a felony, both the transferor and the transferee are held jointly and severally liable for obligations arising after the transfer.

Unless otherwise agreed, any collective bargaining agreements applicable to the affected employees continue to apply until they expire or a new collective agreement is applicable.

If there is a significant change in the ownership of the employer resulting in a change in the board of directors, the main activity or approach to the activity, top executives (normally, the general manager) have the right to terminate their contracts and receive a severance compensation of seven days of cash salary per year of service up to six months' salary. The employee can terminate the contract in the three-month period following the implementation of the change.

Approval or consultation requirements

Works council/employee information requirements

If the transfer of undertakings involves an automatic transfer of employees, both the transferor and the transferee are obliged to notify the employees' representatives (or the affected employees in the absence of representation) of the proposed business transfer. The notification should be provided reasonably in advance, normally no less than 15 days. In a merger or company spin-off, the relevant information should be provided when the shareholders' meeting is called to approve the merger/spin-off.

Works Council consultation requirements

If the transferor or transferee anticipates adopting new measures in connection with the employees as a result of the transfer, depending on the measures to be adopted, they may be obliged to consult with the employees' representatives and to follow specific procedures established by law.

Tax

The acquisition of shares is usually not subject to indirect taxation, unless the target company owns significant real estate (>50% of total assets).

For Spanish tax resident sellers subject to corporate income tax, the capital gain arising from the sale of shares is usually exempt from taxation, provided several requirements are met (i.e., >5% of ownership for the last 12 months, the company is not a mere asset holding company, and it is subject to corporate income tax). Individual sellers are taxed under personal income tax at a rate that ranges from 19% to 23%.

For foreign tax resident sellers, the capital gain from the sale of shares is usually subject to a 19% tax rate, unless a double tax treaty provides otherwise.

The acquisition of assets may be subject to either transfer tax or VAT (and stamp duty, if applicable), depending on whether or not the deal qualifies as a transfer of going concern. A transfer of going concern is not subject to VAT, but certain assets (such as real estate assets) may be subject to VAT.

For Spanish tax resident sellers subject to corporate income tax, the capital gain from the sale of assets is usually taxed at a 25% rate. Individual sellers are taxed under personal income tax at a rate that ranges from 19% to 23%.

For foreign tax resident sellers, the capital gain from the sale of assets is usually subject to a 19% tax rate, unless a double tax treaty provides otherwise. If the seller is a non-resident, the purchaser is obliged to withhold 3% of the gross amount to be paid on account of the seller's non-resident income tax ("**NRIT**").

Spanish tax laws provide a special tax neutrality regime for corporate reorganizations (mergers, carve-outs, assets contributions, etc.) that allow the taxpayer to defer taxation of built-in gains arising from a reorganization that is conducted for valid economic reasons.

Post-acquisition integration

The Spanish Act on Modifications of Business Structures provides different types of transactions (i.e., mergers, de-mergers, conversions and global assignment of assets and liabilities), which, in principle, involve the transfer by operation of law of all the legal relations affecting the entities or businesses that are to be merged or demerged, in favor of the beneficiary entity. These processes usually involve a waiting period for creditors and are carried out on the basis of a balance sheet (duly audited if the company is subject to mandatory audit).

There are additional alternatives for post-acquisition integration which do not involve the benefit of the transfer by operation of law, but that could be appropriate depending on the nature of the assets or peculiarities of the transaction itself, such as capital increases by contribution in kind or direct contributions to the equity of the company.

Common deal structures

What are the key private M&A deal structures?

Spanish M&A practice is increasingly internationalized and Spain can be considered a sophisticated market for M&A transactions. Business acquisition agreements are not regulated by any specific law and their structure and content can and will vary greatly depending on the particularities of the transaction and the covenants, agreements and undertakings of the parties to the agreement.

Share acquisitions and asset acquisitions are the key deal structures used in Spanish private M&A transactions. Other types of acquisition methods, such as mergers, may also be suitable depending on the circumstances. Schemes of arrangement are not contemplated by Spanish law.

Spanish M&A practice is familiar with both bilateral sales and auction sales. Auction processes are normally governed by a process letter prepared by the seller's advisers and structured in several phases: in an early stage of the process, bidders are normally asked to submit an indicative (non-binding) offer on the basis of preliminary information and due diligence; as the process moves forward, those bidders who are pre-selected after the initial phase are normally requested to submit (after appropriate due diligence) a binding offer, together with a mark-up of the acquisition agreement previously delivered by the seller for these purposes.

In Spain, share purchases are generally more common than asset purchases. However, an asset purchase has advantages that may, in certain circumstances, make it more attractive to a purchaser, e.g., the purchaser might favor an asset purchase in order to limit inheritance of liabilities to the assets acquired, rather than to the whole company (although the purchaser may in any case be liable for certain pre-transfer liabilities in relation to labor, tax and environmental matters).

Under Spanish law, two or more companies can merge either by incorporation or by absorption.

In mergers by incorporation, the merging companies are wound up without going into liquidation and are succeeded by a new company, incorporated as a result of the merger, which acquires, by universal succession (transfer by operation of law), all assets and liabilities (including contracts, except where the contract itself prevents such a transfer). The former shareholders of the extinguished companies become shareholders of the successor company in accordance with the share exchange rate agreed as part ofthe merger.

In mergers by absorption, one or more companies (the absorbed companies) are wound up without going into liquidation and are absorbed by another company (the surviving company), which acquires, by universal succession, all their assets and liabilities. The former shareholders of the absorbed companies become shareholders of the surviving company in accordance with the share exchange rate agreed as part of the merger.

Mergers can thus be used in Spain as an alternative business transfer method, and Spanish law additionally regulates other reorganization operations, including partial or total de-mergers or spin-offs, and global assignments of assets and liabilities, which also have the advantage of universal succession.

Spanish law allows and regulates all of such reorganization operations cross-border.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

Spanish corporate law provides for a wide range of company types. The most commonly used are limited liability companies, either in the form of:

- *Sociedades Anónimas* (SA, i.e., 'corporations'); or
- *Sociedades de Responsabilidad Limitada* (SRL or SL, i.e., 'limited liability companies').

Sole shareholder companies are permitted under Spanish law and no major restrictions apply to them, other than the requisite of adding the word 'unipersonal' (i.e., 'sole shareholder') or its abbreviation 'U' (so we often see 'SLU' or 'SAU') to the corporate name and the obligation to keep a special book to record agreements between the company and the sole shareholder.

SAs are the most common corporate vehicle in Spain for multinationals and listed companies. However, the use of SLs is more frequent, since Spanish corporate law establishes more stringent requirements to operate an SA, including the increase of the minimum capital required to incorporate a company.

What are the different types of limited liability companies?

In contrast to SAs, SRLs were originally conceived to be used for small or family-owned companies where trust and personal relationships are the founding principles. For this reason, the legal structure and operational mechanisms of an SRL are less sophisticated and in general more flexible than those of an SA. That said, Spanish corporate law imposes significant restrictions on the transfer of quotas of SRL companies and the statutory voting requirements are more stringent than those applicable to an SA. Nowadays, most of the Spanish subsidiaries of multinational companies adopt the form of SRL companies. The minimum capital amount required to incorporate an SRL is EUR 3,000, all of which must be paid in upon incorporation.

Is there a restriction on shareholder numbers?

There is no restriction on the number of shareholders. Therefore, both SAs and SRLs can have as many shareholders as convenient on the basis of the particular circumstances of the relevant transaction.

What are the key features of a share sale and purchase?

Spanish practice is familiar with the main international standards with respect to structure and content of the agreements governing the acquisition of shares. A share purchase agreement ("**SPA**") is usually prepared and it is fairly common to face provisions relating to price determination and adjustment (cash-free debt-free/normalized working capital adjustment, NAV adjustments, locked box structures, earn-outs, etc.), conditions precedent to completion, including mandatory (such as merger control, if applicable) and voluntary conditions (such as material adverse effect conditions or waiver to change of control provisions), interim period obligations, representations and warranties, and indemnity undertakings.

In terms of transfer formalities:

- Shares in SA companies may be represented either by share certificates or accounting entries, and may be freely transferred (unless the bylaws set out otherwise when shares are registered, e.g., specific transfer restrictions, such as first refusal rights in favor of other shareholders or the company itself). If shares are represented by share certificates, they can be transferred by endorsement of the relevant share certificates to the purchaser. Transfer of unregistered (bearer) shares is performed by handing over the relevant certificates, but the transfer will not be effective vis-à-vis third parties until notarized before a notary public (for transfers carried out without the intervention of a financial institution or securities broker). Notarizing transfers of shares (even if not legally required) is common practice. Transfers of registered shares must also be recorded in the shareholders' register.

- SL share capital is represented by quotas, which are not 'negotiable securities' and cannot be represented by share certificates or accounting entries. An SL cannot be listed on the securities markets. SL quotas must be transferred by means of a notarial deed (and the transfer recorded in the quotaholders' register).

Share deals are not subject to consultation or approval by employees, although it is common practice to inform employees as a matter of courtesy. However, if as part of the share deal it is envisaged that employment-related measures will be adopted that will imply material changes in the working conditions, geographical mobility, dismissals, etc. of the employees, it will be necessary to open a consultation with employee representatives to inform and negotiate with those representatives regarding the measures to be taken and their effect on employee working conditions — following the procedures set out in the Spanish Workers' Statute.

Share deals may be subject to the approval of the general shareholders' meeting. In this regard, Article 160 of the Spanish Companies Act requires that any acquisition, sale or contribution to another company of material assets must be approved by the general shareholders' meeting. The Companies Act presumes that, in any event, an asset is material when the amount of the transaction exceeds 25% of the total value of the assets in the last approved balance sheet.

What are the key features of an asset sale and purchase?

An asset purchase agreement ("**APA**") is usually prepared to record the agreement of the parties on their respective rights, obligations and liabilities in connection with the transaction. In asset deals, it is common to see most of the topics described above in respect of the share deals, including purchase price adjustments, conditions precedent to completion, interim period obligations, and warranties and indemnities.

In relation to transfer formalities, each individual asset, liability and contractual position within the scope of the agreement must be transferred in accordance with the particular transfer formalities that apply to it. In this sense, the following should be highlighted:

- For some assets, the transfer formalities will be fulfilled simply by delivering the asset to the purchaser, but in other cases the formalities are more prescriptive, as is the case with real property (which requires notarization and registration with the relevant public registry), in rem rights (e.g., mortgage, pledge), or intellectual property (e.g., trademarks).
- Permits and licenses are not automatically assigned in transfers of the business's entire assets (i.e., transfers of going concerns), so an application for consent to assign will have to be made to the relevant authority, or a new license or permit will be required, which may be a disadvantage for some asset deals.
- Contracts are not automatically assigned either, unless the assignment is specifically permitted under the relevant contract.
- In some cases, particularly when the asset transfer refers to a business unit that is transferred as a "going concern," tax, labor and environmental liabilities may be transferred to the purchaser as a matter of law.

- Asset deals do not require prior consultation with or approval of employees, although there is an obligation to inform employees where an entire business is being sold. As with share acquisitions, if as part of the asset deal it is envisaged that employment-related measures will be adopted (e.g., material changes in working conditions, geographical mobility, dismissals, etc.), it will be necessary to open a consultation with employee representatives to inform and negotiate with those representatives regarding the measures to be taken and their effect on employee working conditions — following the procedures set out in the Spanish Workers' Statute.

As in the case of share deals, asset deals may be subject to the approval of the general shareholders' meeting. In this regard, Article 160 of the Spanish Companies Act requires that any acquisition, sale or contribution to another company of material assets must be approved by the general shareholders' meeting. The Companies Act presumes that, in any event, an asset is material when the amount of the transaction exceeds 25% of the total value of the assets in the last approved balance sheet.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

Letters of intent and term sheets are common in Spain. Although they are non-binding by nature, the binding character of the document will ultimately depend on the precise content and wording of the document, as well as the circumstances surrounding the transaction and the parties' conduct.

The content of these types of documents is normally dual: on the one hand, the parties set out the anticipated terms of the proposed transaction and other ancillary matters on a non-exhaustive and non-binding basis; on the other hand, the parties set out certain obligations and undertakings in connection with the negotiation process generally, which are intended to be legally binding and enforceable in accordance with their terms. Binding provisions usually include confidentiality, exclusivity, expenses and taxes, governing law and jurisdiction/arbitration.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: It is common to include an exclusivity clause prohibiting the parties from negotiating and exchanging information with third parties during a limited period of time. Normally, the exclusivity undertaking is assumed by the seller (so it undertakes to negotiate with the purchaser only), is configured as a binding commitment and, depending on the particularities of the transaction and the bargaining position of the parties, can be supplemented by a penalty clause.
- Break fee: It is not common to include break fees in letters of intent, unless linked to any breach of binding obligations (e.g., breach of an exclusivity undertaking).
- Confidentiality: It is typical to include a broad provision on confidentiality regulating the exchange of information and documentation between the parties. As in the case of exclusivity, confidentiality provisions are configured as binding and, depending on the particularities of the transaction and the sensitivity of the information to be exchanged, can be supplemented by a penalty clause.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Exclusivity agreements and confidentiality agreements are relatively common in Spain. However, it is also common to include a comprehensive confidentiality/exclusivity clause in the term sheet or letter of intent rather than a separate agreement.

The decision to configure the relevant undertaking as part of the term sheet/letter of intent or as a separate agreement will depend on the particularities of the transaction (complexity, duration of the negotiations, sensitivity of the information to be disclosed, timing of the information disclosure, etc.).

Is there a duty or obligation to negotiate in good faith?

The parties in an M&A negotiation are under a duty to act in good faith. Anyone in breach of this duty will have to compensate for direct damage caused (normally the costs of the negotiations) in the event of an unjustified breach of negotiations.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: fairly common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: cash free/debt free with a normal level of working capital (purchase price based on EBITDA multiple (or other multiplier)) is fairly common, as well as locked box structures. NAV is rarely seen, though this type of adjustment may be particularly relevant in certain cases (e.g., in businesses where there is regular movement in the fixed assets). In view of the recent COVID-19 crisis and eventual changes/challenges in valuation criteria as a consequence of such crisis, it is possible that the traditional approach to the purchase price determination and adjustment and related provisions is adapted to new valuation or investment structures.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually prepared by the buyer although, depending on the particular circumstances of each case, it is not uncommon for the seller to prepare the closing balance sheet.

Is the balance sheet audited (where applicable)?

Frequency/market practice: not necessarily, although common in medium-sized and large deals.

Is an earn-out common?

Frequency/market practice: these are used particularly in industries where sellers continue to be involved. (e.g., advertising). Considering the impact of the COVID-19 crisis on business activity and thus in the business valuation, earn-outs can become more popular in other scenarios.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: fairly common.

Is a break fee common?

Frequency/market practice: rarely, although it may be used in certain cases depending on the circumstances of each particular deal.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: MAC/MAE provisions are familiar to Spanish market practitioners. The decision regarding the inclusion of a MAC/MAE condition precedent in the agreement will ultimately depend on a number of factors, including the strategies and bargaining position of the parties, the length of the interim period between signing and closing, the type of deal and the nature of the business being sold. However, considering the general uncertainty derived from the COVID-19 crisis and the risk of new outbreaks, it is possible that MAC/MAE provisions become more common in instances where they weren't before the crisis.

Is the MAE general or specific?

Frequency/market practice: specific is more common, although please see our comment above with respect to eventual changes in market trends as a consequence of the COVID-19 crisis.

Is the MAE quantified?

Frequency/market practice: fairly common, although please see our comment above with respect to eventual changes in market trends as a consequence of the COVID-19 crisis.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common; more common in certain sectors and if sellers are individuals.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: fairly common.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: common (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common in conjunction with a non-compete.

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: fairly common.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; generally, access is obtained for private deals, but some sellers resist and seek to mitigate this by adding exceptions and limitations. There are competition law issues around potential 'gun-jumping.'

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: fairly common; updating schedules is common but limited to things like lists of contracts or employees in the ordinary course of business. Confirmation of representations and warranties at closing is common. Where there is a material breach, there may be a right to terminate.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers commonly seen and often quantified by reference to a euro amount.

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge is often qualified (frequently by reference to a specific group).

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common.

Is disclosure of the data room common?

Frequency/market practice: it is very common to negotiate the disclosure of the data room and the effects of such disclosure on the seller's liability.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common; repetition at completion is common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: this is not common between signing and completion.

Is a bring-down certificate at closing common?

Frequency/market practice: a bring-down certificate at completion is common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate in all material respects is common.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: common.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: it depends on the particulars of each transaction. In general terms, it is not unusual to see ranges from 10%-50% of the purchase price in larger deals and up to 100% in small deals.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: they usually apply to warranties only.

What are the common exceptions to the cap?

Frequency/market practice: key warranties are often excepted (e.g., title, capitalization, authority). Tax and other specific areas of concern/identified liabilities generally are not capped or have higher caps.

Is a deductible or basket common?

Frequency/market practice: both are common.

Is a *de minimis* common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: fairly common; a general survival of 12–24 months is common.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: it is common to carve out fraud, tax and social security (statute of limitations).

Is warranty insurance common?

Frequency/market practice: warranty insurance is increasingly seen in the Spanish market and is becoming more popular in certain deals (for instance, when the seller wants a clean exit).

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common; common for actually received.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common; common for actually received.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: fairly common.

Is there an exclusion of consequential damages?

Frequency/market practice: it is fairly common to negotiate the definition of damages, including or excluding certain items (such as consequential damages or loss of profit) on the basis of each particular case.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: it is common to have provisions dealing with the impact of the knowledge of the buyer. Depending on the parties' respective bargaining position and the particulars of each case, knowledge of the buyer may or may not exclude the seller's liability for breach of warranties.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: it is common to choose Spanish law if the target is in Spain.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is more common. ICC arbitration in London or Paris or arbitration administered by a Spanish arbitral body in a Spanish venue is common.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: no stamp duty is payable on share sales (unless the assets of the target include real estate under certain circumstances).

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: fairly common.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Sweden

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

Due diligence in Sweden is typically fairly narrowly scoped, with a focus mainly on identifying findings of some materiality. Due diligence reports are generally limited to material issues and practical matters that need to be handled in connection with the transaction, and are not very descriptive, unless requested by the buyer. Experienced buyers may request that the due diligence report also focus on matters of importance for the post-closing integration.

The focus areas of the due diligence depend on the nature of the business of the target. In recent years, trade compliance, privacy, anti-bribery, information security and related matters have risen in prominence due to an increased focus on compliance in general.

Independent appraisal

No independent appraisal report to support the valuation of the target company is required in a share deal or in an asset deal. Buyers typically rely on their internal valuations.

Payment

Wire transfers of funds are common and wire transfers through the SWIFT Code international system are also common.

There are no foreign exchange control restrictions or other approvals required to transfer funds into Sweden.

Signing/closing

Share sale

Whether signing and closing is simultaneous depends on whether there are conditions that must be satisfied, including regulatory approvals (e.g., merger control), divestments of certain parts of the target entity, third-party consents/waivers, drawdown of funds, or the resolution of issues discovered during due diligence. Simultaneous signing/closing is common where there are no such conditions to consider.

Asset sale

Simultaneous signing/closing is also common in asset sales where there are no conditions that will delay closing to take into account.

A local acquisition vehicle company may be set up in Sweden in a matter of days. Tax registration may take 4-8 weeks but the company may start operations as of filing the tax registration application. No general business licenses are required. In some cases, the company may require industry-specific permits and/or licenses.

Approvals/registrations

Foreign investment

Sweden does not require investors to obtain any foreign investment permits or licenses.

Merger control

The Swedish Competition Authority ("**SCA**") may prohibit an acquisition or merger (including, under certain conditions, the creation of a joint venture) if it is liable to significantly impede the existence or development of effective competition in the country as a whole, or a substantial part of it. The Swedish competition test corresponds to the approach adopted in the EU Merger Regulation.

If it is sufficient to eliminate the adverse effects of an acquisition or merger, a party, instead of being subject to a prohibition, may instead be required to make commitments such as divesting an undertaking, or a part of an undertaking, or to take some other measure having a favourable effect on competition.

The thresholds for mandatory notification in Sweden entail two separate but cumulative thresholds (based on the figures for the preceding financial year):

1. combined aggregate turnover in Sweden exceeds SEK 1 billion; and
2. turnover in Sweden exceeds SEK 200 million for each of at least two of the undertakings concerned.

If the parties' combined turnover in Sweden exceeds the first SEK 1 billion threshold, but not the second SEK 200 million threshold, a party can voluntarily notify, or the SCA can require a notification, where special circumstances exist.

An example of special circumstances is a situation where a strong market operator in a concentrated market acquires a newly established competitor to prevent the new competitor to compete with the acquiring company. In addition, (valid) complaints to the SCA from customers and/or competitors may potentially trigger a notification order from the SCA. It is unlikely for special circumstances to be at hand if the target's turnover in Sweden does not exceed SEK 25 million.

Notification must normally be made by the party or parties acquiring control (i.e., the buyer/buyers).

Other regulatory or government approvals

In general, the sale of shares or assets of a Swedish company does not require other regulatory or government approvals. In some, fairly rare, cases, the company may require industry-specific regulatory or government approvals.

Employment

Share sale

In a share acquisition, the employment conditions of the employees of the target company remain unchanged since the employer remains the same. In share transfers, the target company is normally not obligated to consult with any union. However, if the seller is bound by a collective bargaining agreement ("**CBA**"), and the transaction would entail a substantial change to the seller's business, the seller may be obliged to consult any union whose members are affected by the pending transaction, and if the transaction would entail a substantial change to the seller's business, the seller would then be obliged to consult the unions with which it is bound by a CBA. Similarly, should the transaction entail a substantial change to the working or employment terms and conditions of any employees who are members of any of those unions, the relevant unions should also be consulted.

Asset sale

In an asset transfer, Sweden has implemented EU Directive 2001/23 relating to the safeguard of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses. This means that on the transfer of an undertaking or a division of an undertaking, the employees are entitled to transfer to the buyer. The transferred employees have the right to transfer on unchanged terms and conditions of employment. The only change is that the buyer is the new employer under the contracts of employment.

In Sweden, an employee may object to being transferred to a new employer. If an employee refuses to transfer, the employee will remain employed with the seller but may then be exposed to a potential redundancy scenario.

If there is a CBA in place, the seller is obliged to consult with the relevant unions, or in the absence of any CBA, with any union that has members among the impacted staff, about the pending decision to transfer the business. The unions cannot veto the employer's decision, but are merely entitled to be consulted before the decision is made. If the consultation is not concluded properly, the employer will be liable for damages to the unions.

If the buyer has no CBA, it will be bound by the CBA of the seller upon the transfer. This could be avoided if the seller terminates the CBA prior to the transfer. Some provisions of the CBA will remain for an interim period.

Tax

The statutory CIT rate in Sweden is 21.4%.

No stamp tax or other similar taxes or charges are payable in connection with the execution, delivery, performance or enforcement of a share acquisition.

Stamp duty is only payable on the transfer of real property if the real property is sold as an asset.

Sweden levies withholding tax on dividends. The statutory withholding tax rate is 30% if the dividend is paid to recipients that are not subject to tax in Sweden.

Dividends are however often exempt from Swedish withholding tax, or subject to a reduced rate of withholding tax, by virtue of applicable tax treaties and exempt by way of available reclaim mechanism in several situations, for example if the holding criteria in the Parent-Subsidiary Directive are met.

No withholding tax is levied on interest payments and Sweden has no formal thin capitalization rules in place. Interest expenses relating to debts provided by other group companies may, however, only be deducted if certain criteria are met, e.g., the recipient of the interest is taxed at least 10% and the main reason for the debt is not for the group to receive a tax benefit. These rules are very complex and a proper debt analysis should be conducted before any debt pushdown or other intra-group lending. Interest income will be subject to corporate income tax at statutory rates.

No withholding tax on royalties is applicable. However, unless exempt in accordance with a tax treaty or as a result of the EU Interest/Royalty Directive, foreign recipients of royalties paid by Swedish companies are deemed to have a permanent establishment in Sweden from which the royalty is considered to be paid. The royalty payments are taxed as income from the permanent establishment in Sweden.

Foreign shareholders of Swedish companies are not subject to tax on capital gains in Sweden, unless the shares are allocated to a permanent establishment in Sweden. As a consequence of the Swedish participation exemption rules, capital gains from the sale of shares or partnership interests by Swedish companies are exempt from CIT if the sold shares have been held for business reasons. Correspondingly, the acquisition cost is neither deductible nor depreciable. Non-listed shares/interests held as capital assets are always considered held for business reasons. Listed shares/interests held as capital assets are considered held for business reasons if the shares/interests have been held for at least 12 months and the holder controls at least 10% of the votes or holds the shares as a result of the business conducted by the holder or an affiliate of the holder. If shares are held in an EU company, the shareholding qualifies as holding for business reasons also if the holding is at least 10 percent and the shares are current assets, provided that certain conditions are met.

Sweden has a tax consolidation regime in place. A Swedish parent company owning more than 90% of a subsidiary may give or take a group contribution to/from the subsidiary, provided that the ownership has existed during the entire fiscal year of both companies or since the subsidiary started its business and provided that returns are submitted to the Tax Agency in the same submitting period. Consolidation is also allowed between two subsidiaries.

Tax losses (NOLs) may be carried forward indefinitely. Tax losses carried forward may be transferred with the company, but following a change of control in a company (i.e., when the decisive influence over the company has changed), there may be restrictions on the right to deduct losses. These rules are complex and a proper analysis should be conducted before directly or indirectly acquiring a Swedish company with tax losses.

As member of the EU, Sweden has implemented the EU VAT directive. VAT is levied on the transfer of most goods and the provision of most services. The standard rate is 25%. A transfer of shares is VAT exempt under the Swedish VAT Act. Sweden also has transfer of going concern rules in place with the effect that transfer of a well separated business is out of scope of VAT provided that the recipient intends to continue the business and is able to recover VAT.

Post-acquisition integration

Planning is key for a successful post-acquisition integration to identify any tax, legal or operational blocking points or issues that need to be resolved prior to the integration.

Post-acquisition integration is usually made by way of asset transfer or merger.

An asset transfer is quicker and can be completed in a short period of time. A merger takes about three months to complete. The process for merging a subsidiary is slightly simplified as compared to sister companies.

As a general rule, consent is required to transfer any third-party contracts by way of asset transfer, whereas in a merger, contracts transfer by way of universal succession. A merger, however, involves notice to all of the disappearing company's creditors.

There are no general license requirements for carrying out operations in Sweden, but license and permit requirements apply in certain industries. Examples include the healthcare and financial services industries and businesses with environmental impact. In these situations, time needs to be built into the integration planning for obtaining the necessary permits and licenses.

Transitional services arrangements are common where only part of the operations of the seller are sold and the business may not be able to function on a standalone basis immediately.

Transferred employees have the right to transfer on unchanged terms and conditions of employment. Union consultations may be required. Harmonization of the employment terms and conditions to adapt to the terms applied at the buyer is normally done during the year following the transfer.

Common deal structures

What are the key private M&A deal structures?

The purchase of a Swedish business can take a number of different forms. There are basically three vehicles for taking control of a business in Sweden: via the acquisition of shares; acquisition of assets; or a merger. The most common form of acquisition, especially for the acquisition of a larger business, is the purchase of shares. Transfers of assets are frequently used where only part of a business is transferred and are sometimes preferred in respect of the sale of small businesses. Asset deals may also be negotiated where a purchaser wishes to avoid taking on certain identified liabilities and the seller's position is such that it feels obliged to accept an asset deal. Mergers are seldom used for acquisitions, but are used more frequently for internal reorganization purposes.

In recent years, auction processes have become increasingly common, as competition for target companies has increased. In the auction context, bid process letters are used and bidders are typically instructed to submit an indicative offer initially. Bidders that proceed to the next phase may thereafter be instructed to submit a final offer, after having had the opportunity to conduct further due diligence. This final offer may be binding, but always subject to negotiation of the final sale and purchase agreement.

In the non-auction context, it is common for the parties to agree on a letter of intent or similar non-binding arrangement setting out key terms of the transaction, prior to spending time and resources on entering into a binding agreement.

The Cross-Border Directive applies to mergers of limited liability companies formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community, provided at least two of them are governed by the laws of different Member States.

Swedish limited liability companies may merge only with companies with legal residence within the European Economic Area ("**EEA**"). In practice, companies registered within the EEA will almost always be regarded as having their legal residence in the EEA.

Under the Companies Act, a merger may take place:

- between an acquiring company on the one hand and one or more transferring companies on the other hand, where the acquiring company remains in existence (absorption); or
- between two or more transferring companies that form a new, acquiring company, where none of the existing companies remain in existence (combination).

The Companies Act also contains rules on the demerger of companies. Under these rules, demerger may either be effected by:

- the acquisition of all rights and obligations of the company being divided by one or more companies, after which the company being divided is dissolved without prior liquidation proceedings; or
- one or several companies acquiring the rights and obligations from the company being divided without dissolving it.

In both cases, consideration will be paid to the shareholders of the company being demerged, either in the form of cash or in the form of shares. At least half of the consideration should generally consist of shares.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

The Companies Act provides for two forms of limited liability companies: private and public. The private limited liability company is the only private company form used in Sweden.

What are the different types of limited liability companies?

A private limited liability company is not allowed to offer its shares to the public. The shareholders' liability is limited to the amount paid (if any) for shares that they own. The minimum share capital for private companies is SEK 25,000.

Swedish limited liability companies are managed by a board of directors and usually a managing director. The board of a private limited liability company must consist of at least one director. If the board consists of one or two directors, at least one deputy director must be appointed. The managing director and at least half the number of directors and deputies, if any, must, subject to permission from the Companies Registration Office, be resident in the EEA, i.e., the EU Member States, Norway, Iceland and Liechtenstein. If a managing director has been appointed, he or she is responsible for the day-to-day management of the company.

Is there a restriction on shareholder numbers?

No.

What are the key features of a share sale and purchase?

Shares in a Swedish company constitute personal property. Thus, the Sales of Goods Act (1990:931) is, *prima facie*, applicable to their sale and purchase. However, it is not entirely clear to what extent the Sales of Goods Act is pre-empted by the Act on Debt Instruments (1936:81). The issue is relevant because if the Sales of Goods Act applies, then (in the absence of express agreement between the parties) a number of provisions of the Sales of Goods Act detailed below would be applicable to a sale of shares. If not, then the Act on Debt Instruments provides that the seller is not responsible for the solvency of the transferred goods unless it has been warranted or represented by him/her.

Case law indicates that the Sales of Goods Act applies if all the company's shares (or a majority of them) are sold, while the Act on Debt Instruments is applicable if only a small portion of shares are sold. It is not clear, however, what proportion of shares in terms of percentages is involved and when one act takes over from the other. Purchasers of shares therefore normally require warranties and representations from the seller.

It is possible to contract out of the Sales of Goods Act and this option is used in most cases.

What are the key features of an asset sale and purchase?

In the case of an acquisition of assets, the Sales of Goods Act will, however, apply. This act establishes strict requirements and, accordingly, purchasers should seek extensive indemnifications and sellers should be wary of giving extensive representations and warranties. The Sales of Goods Act regulates the relationship between seller and purchaser. The act contains provisions concerning the determination of price, place of delivery of the goods and the time for the performance of the purchase contract, any right of retention of goods or withholding of payment, the risk of loss of the goods, the yield on the goods, delays on the part of the seller or the purchaser, defects and deficiencies in the goods, interest payable on the price and insolvency rules. Furthermore, the act regulates the rejection of goods and the repudiation of contracts of purchase, and title to the goods. However, the act is not mandatory and is usually excluded by agreement between the parties.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

A letter of intent or term sheet will be entered into in most privately negotiated transactions. Typically, a letter of intent or term sheet would be non-binding on the parties except in relation to clauses such as confidentiality and governing law and dispute resolution. However, the parties should clearly set out in the letter of intent or term sheet whether the parties intend to be bound or not (or that only certain clauses shall be binding). If the parties do not provide that the document is not intended to be binding, it will generally be considered binding under Swedish law.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: A term sheet customarily includes provisions on exclusivity during a certain period of time.
- Break fee: Break fees are rarely used but it is possible to implement and enforce break fees where the parties agree. If break fees are used, they typically intend to cover the costs of due diligence, etc.
- Confidentiality: A term sheet customarily includes provisions on confidentiality.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

A confidentiality undertaking or an NDA governing primarily the exchange of confidential information relating to the transaction is often negotiated as a separate agreement at the outset of the transactions, before the parties start exchanging information in connection with a potential transaction or enter into any other term sheet or agreement. Other provisions are typically not supplemented with separately negotiated agreements. The term sheet as such is usually considered sufficient.

Is there a duty or obligation to negotiate in good faith?

There is no general duty to act in good faith. A party is free to continue discussions in connection with a potential purchase agreement as long as there is a chance, no matter how small, that a transaction may occur as a result of the negotiations. If, however, it becomes clear to a party that it will not pursue a transaction, such party should not continue negotiations in bad faith. If a party continues negotiations knowing that there will not be a transaction, such party may be held liable to pay damages.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: fairly common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: locked box mechanisms have become increasingly common, but cash free/debt free and working capital adjustments are still common. NAV rarely seen.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: the first draft is usually prepared by the buyer.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely.

Is an earn-out common?

Frequency/market practice: fairly common; it is more common in smaller transactions, particularly if seller retains stake. In recent years, earn-outs have again grown in popularity and use.

Is a deposit common?

Frequency/market practice: rarely; extremely uncommon.

Is an escrow common?

Frequency/market practice: rarely; escrow arrangements are not used as often as they used to be.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: rarely; very uncommon.

Is the MAE general or specific?

Frequency/market practice: both are seen (even though MAEs are very uncommon in Sweden).

Is the MAE quantified?

Frequency/market practice: rarely.

Covenants

Is a non-compete common?

Frequency/market practice: common, but rarely from private equity sellers.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: rarely; waterfall provisions uncommon.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: very common in conjunction with a non-compete.

Are non-solicitation provisions (of customers) common?

Frequency/market practice: very common in conjunction with a non-compete.

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common; it is customary to include restrictions on the seller in relation to the conduct of the target's business in the period between signing and completion. Note that there may be competition law issues around potential 'gun-jumping,' so such restrictions need to be carefully considered.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; note that there may be competition law issues around potential 'gun-jumping,' so such rights need to be carefully considered and limited.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: it is fairly common to update disclosures. Updating schedules is common but limited to things like lists of contracts. Notification of possible breach is common. In the case of a material breach, there is usually a right to terminate.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen, but are often not quantified (other than specific warranties, e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Analysis: knowledge qualifiers are common, often limited to the actual knowledge and due enquiry of a specified list of senior management.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: common.

Is disclosure of the data room common?

Frequency/market practice: very common; market practice in Sweden is full disclosure of what has been fairly disclosed in the data room.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: very common; repetition at completion is common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: it is rare and not at all common to repeat warranties at all times between signing and closing.

Is a bring-down certificate at closing common?

Frequency/market practice: rarely; bring-down certificates are not very common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: very common; true and accurate in all material respects is common but often carve out for fundamental representations, which must be absolutely true.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely; double materiality is usually avoided.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: commonly less than 50%. Mid-cap and larger deals see lower caps, e.g., 10%-30%.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: usually warranties only.

What are the common exceptions to the cap?

Frequency/market practice: fundamental warranties are often excepted (e.g., title, capitalization, authority). Often, tax and specific areas of concern, sometimes with specific higher caps, may be exempt.

Is a deductible or basket common?

Frequency/market practice: a deductible is more often resisted and a tipping basket is more common.

Is a *de minimis* common?

Frequency/market practice: very common.

How long does seller liability survive?

Frequency/market practice: very common; general survival of 12–18 months is common.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: tax is commonly longer than general warranties. Fundamental warranties are usually subject to a longer warranty period. It is common to carve out fraud.

Is warranty insurance common?

Frequency/market practice: it is standard in private equity exits and also becoming more and more common where private equity is not involved.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common; may be limited to tax benefits in the same financial year.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: common for proceeds actually received.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: common for recoveries actually made.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: very common; required by law for damages, but usually explicitly stated in purchase agreement.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common; limitation to 'direct damage' or to direct damage and reasonably foreseeable consequential damage is common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: very common.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: it is generally accepted market practice that Swedish law applies for Swedish target companies.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is used in the vast majority of agreements. Stockholm Chamber of Commerce in most cases; ad hoc procedures under the Swedish Arbitration Act, as well as ICC in Stockholm are also seen.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: no stamp duty is payable on transfer of shares.

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: rarely; this is uncommon.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Switzerland

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

The focus of a legal due diligence in the context of mergers and acquisitions in Switzerland will mainly depend on the industry involved as well as the target company's age, size and structure (start-up, market leader, etc.). However, the following issues are typically considered in a due diligence: corporate matters (e.g., issues in connection with evidencing a proper share history of the target company often arise), commercial contracts (e.g., change of control or exclusivity provisions in material agreements), financing/loan agreements, real estate (e.g., land register entries, leases), employment matters, IP, litigation, regulatory and compliance issues (e.g., environmental law, data protection, industry-related compliance).

A legal due diligence usually entails a review of the relevant documents which are in the vast majority of cases provided in virtual data rooms. Issues identified by the parties or their respective counsels are then generally either remedied prior to signing or dealt with when negotiating the terms of the transaction (e.g., conditions precedent to closing, reduction of purchase price or specific indemnities).

Independent appraisal

Swiss law does not require an independent appraisal for private share or asset deals. Financial due diligence is common, especially for larger transactions.

Independent appraisers are usually involved by the parties if the share purchase agreement includes a post-closing purchase price adjustment. In such cases, a provision is common according to which any party may refer the determination of the purchase price adjustment to an independent expert if the parties cannot agree on a proposed adjustment.

Payment

In general, apart from tax considerations, there are no restrictions with regards to pricing, currency or payment of the purchase price in relation to a share or asset deal provided that a minimum purchase price must be agreed.

Signing/closing

Share sale

The purchase of shares of a Swiss company is usually agreed upon in a comprehensive share purchase agreement. While no notarization is needed, a share purchase agreement is almost exclusively concluded in writing and will govern the rights and obligations of the parties.

Asset sale

The structure, content and form of an asset purchase agreement will depend on the assets in question (a public deed is required in case of a transfer of real estate). Swiss law enables the universal transfer of assets and liabilities (e.g., a business) by operation of law under the Merger Act. The Merger Act entails an enhanced protection of creditors, in particular the three-year joint and several liability of the transferor of liabilities. This is one of the reasons why asset deals are today still usually carried out by way of an individual transfer of assets and liabilities. However, the universal transfer of assets and liabilities under the Merger Act may prove useful in particular in the event several real estate properties are to be transferred in which case only one public deed is required and all concerned real estate properties are transferred at the time the transfer agreement is registered with the commercial register.

Closing

In major transactions, signing and closing will often not occur simultaneously, either due to mandatory approvals (e.g., merger control approval) or closing being subject to certain further conditions precedent.

Approvals/registrations

Foreign investment

Switzerland welcomes foreign investments and there are no significant restrictions for foreign investors or foreign investments in Switzerland. Switzerland does not have a cross-sector foreign investment review based on national interests or national security reasons. Consequently, no specific governmental authority for the screening of foreign investments exists and foreign investors do generally not require a formal approval for their investments in Switzerland.

However, if foreign investments are made in certain regulated industries and sectors in Switzerland, governmental approvals could be required.

Significant restrictions exist for foreign investment in real estate. The acquisition of real estate in Switzerland by foreign investors or foreign controlled companies is governed by the so called Lex Koller and subject to strict restrictions, especially in case of an acquisition of residential or other non-commercial real estate. Such residential real estate properties can only be acquired by foreign investors or foreign controlled companies if an authorization is granted by the competent authority of the Canton in which the real estate property is located. Such an authorization is hardly ever granted. Less (or no) restrictions exists if the acquired real estate properties are used for commercial purposes (such as offices, manufacturing facilities, shopping centers, hotels or restaurants).

In certain regulated sectors, such as financial services, telecommunications, media, aviation or nuclear energy sectors, a state license is required for conducting business in Switzerland. The granting of such a state license to a foreign company or to a domestic company with foreign investors may be dependent on reciprocity and a licensing authority may refuse to grant the respective state license if no reciprocal rights are granted to Swiss citizens or Swiss companies by the respective foreign states.

Merger control

Switzerland applies a pre-merger approval system. Its purpose is to prevent the formation or reinforcement of dominant positions in any given relevant market. A merger under the provisions of the Swiss Cartel Act includes any form of transaction by which one or more undertakings acquire direct or indirect control of one or more previously independent undertakings or parts thereof. Accordingly, the scope of the pre-merger control system covers not only mergers and acquisitions but also any contractual or other form of transactions which economically lead to a concentration of enterprises and confer on an acquirer the ability to exercise decisive influence on an independent undertaking. Control may be held by one party alone (sole control) or by several parties acting jointly (joint control).

A notification to, and the approval of, the Competition Commission is necessary if the following thresholds are met:

- the combined aggregate turnover of the enterprises concerned amounts to at least CHF 2 billion worldwide or to CHF 500 million in Switzerland, and
- the aggregate turnover in Switzerland of each of at least two of the enterprises concerned amounts to at least CHF 100 million.

Turnover is calculated on a consolidated basis, but excluding intra-group business. The fiscal year before the merger is relevant. Special rules for the calculation of threshold values apply to the banking (turnover is replaced by gross income) and insurance (turnover is replaced by annual gross insurance premium income) sectors.

Irrespective of any thresholds, notification is mandatory if one party (or another group entity) has been held by a decision under the Cartel Act to be dominant in a domestic market and if the concentration concerns either that market or an adjacent market or a market upstream or downstream.

The Swiss merger control process consists of one or two phases depending on the complexity of the concentration. After the concentration has been notified, the Competition Commission has one month for a preliminary investigation of the contemplated merger (Phase I) and to either clear the concentration or to initiate an in-depth investigation (Phase II), if the Competition Commission finds evidence that the merger could result in the creation or reinforcement of a dominant position. In Phase II, the Competition Commission further examines the concentration and either clears or prohibits it. It is possible that the Competition Commission clears the concentration only subject to certain conditions and obligations. If the undertakings concerned do not receive the decision of the Competition Commission within four months post notification of the concentration it is deemed to be cleared.

The undertakings concerned may not implement a concentration, unless (i) it has been cleared by the Competition Commission, or (ii) the above time limits have expired. Any implementation measure prior to the notification or failure to notify can be fined up to CHF 1 million by the Competition Commission and in case of repeated failure, with an amount up to 10% of the total turnover in Switzerland achieved by all the undertakings concerned. Further, the legal effect of a concentration that has to be notified is suspended until (i) it has been cleared by the Competition Commission, or (ii) the above time limits have expired. Hence, a transaction may be rendered null and void if it is closed prior to clearance.

Employment

Share sale

In share deals, there is no change in the relationship between employer and employee. As a consequence, neither consent from employees nor notices to employees are required due to the sale of the shares as such.

Asset sale

In an asset sale that involves the transfer of a business (or part of a business) as a going concern, employees belonging to the business automatically transfer to the buyer by operation of law, and the parties to the transfer of business are not free to choose which employees will transfer with the business. Employees have a right to object to their transfer within one month from the time they are duly informed about the transfer. This information has to be provided in text format and its content is subject to legal requirements.

Terms and conditions of employment in principle have to remain unchanged after the transfer and the new employer has to recognize the employees' years of service. The buyer as the legal successor of the former employer also becomes fully liable for all employment-related liabilities. Compensation for the automatic assumption of liabilities should be addressed in the transaction documents.

The employer has a duty to inform the works council, or if no works council exists, the employees regarding the reason of the transaction and its legal, economic and social implications in due time before completion. Unless measures affecting the employees are planned in conjunction with the transaction (e.g., split of operations, carve-outs of employees, relocations, dismissals), there is no general legal obligation to consult with works councils or the employees regarding the asset deal and the transfer of the employees. Consultations, if required, may take several weeks and, thus, may significantly impact the timing of the implementation of the respective reorganizations or operational changes.

Pensions

Pension schemes and the transfer of pension liabilities need to be considered carefully in the transaction context, including that Swiss defined contributions plans qualify under IFRS as defined benefit plans and that such requalification may result in unfunded actuarial liabilities.

Tax

In case of an asset deal, the assets sold are, in general, subject to VAT. However, transfer of groups of assets and liabilities that comprise a single autonomous business unit may be transferred by using a declaration procedure instead of invoicing with VAT ("transfer of a going concern" or TOGC). Special transfer taxes may apply in particular in case of a transfer of real estate. The costs of financing are, in principle, fully tax-deductible. However, if financing is provided by a related company, or provided by third parties but guaranteed by a related company, the tax regulations on the maximum debt-to-equity ratios will have to be observed and interest payments made have to comply with the arm's length standard.

In case of a share deal, the transfer of shares is exempt from VAT. It may be subject to transfer stamp tax if the seller, the purchaser or an intermediary is a professional securities dealer. Real estate transfer taxes may apply in some cantons also in case of a share deal. Also, in a share deal tax liabilities embedded in the acquired company are indirectly transferred to the buyer. This may especially apply to the deferred withholding tax liability on the acquired company's distributable reserves not necessary from a commercial point of view for the company's ongoing operations. This applies in particular if there is, upon transfer, "distributable substance from a commercial point of view that is not needed for the company's ongoing operations" in the acquired company and if the applicable withholding tax rate on dividend distributions to the seller (as former shareholder) would have been less favorable than the rate on distributions to the buyer (the "old reserves" doctrine). These reserves remain tainted and subject to the (less favorable) rate applicable to the seller as a former shareholder when distributed to the purchaser.

A capital gain realized by a Swiss resident individual on a sale of shares held as private assets (as opposed to business assets) is, as a general rule, tax-free. Depending on how the acquisition is structured, in particular if the buyer is financing the acquisition with assets of the acquired company, the tax authorities may requalify the tax-exempt capital gain realized by an individual seller as a partial liquidation distribution, and requalify and subject a part of the gain to ordinary income taxation of the seller. It is common practice in Switzerland that a private individual seller may ask for a corresponding representation or an indemnification in case the transaction is qualified as an indirect partial liquidation.

A debt push-down by a merger of an acquisition vehicle and the target company is usually not accepted by the Swiss tax authorities for the purpose of obtaining a tax deduction of the financing costs, as it is usually argued that the merger represents a tax avoidance scheme. Besides that, a debt push-down may trigger the above-mentioned indirect partial liquidation.

A restructuring, in particular mergers, spin-offs and transformation of a legal form, may qualify as a tax neutral restructuring as long as certain general and, depending on the nature of the transaction, other transaction-specific conditions are met. The general requirements are (1) continuation of the tax liability in Switzerland and (2) the book values remain unchanged during the restructuring.

Post-acquisition integration

After the acquisition has been completed, the target business needs to be operationally and/or structurally integrated in the buyer's existing structure.

As part of the operational integration, the buyer typically needs to identify the target's ability to operate and conduct its business after its owner has changed. For purposes of transitioning the business, it may be necessary for the seller to provide to the target and/or the buyer certain transitional services for a certain period of time (e.g., IT services, rental agreements, supplies). During the due diligence phase, the buyer should already closely consider if and to what extent it will be necessary for the seller's group to provide certain transitional services in order to ensure the buyer's ability to continue the acquired business. The entry into of transitional services agreement can be provided for in the share purchase agreement as an action at closing.

With regard to the integration of the target or the target group into the buyer's corporate structure, the Swiss Merger Act provides for various corporate reorganizational measures such as mergers, demergers, conversions and transfers of assets. In addition, it is common to contribute and/or distribute assets and/or shares. The steps are mainly determined by tax considerations both in Switzerland and abroad in case of cross-border group structures. In addition, there are typically also integration steps required from an employment law and pensions perspective.

Common deal structures

What are the key private M&A deal structures?

The sale and purchase of a Swiss business can take a number of different forms but there are basically three mechanisms for taking control of a business in Switzerland: by the acquisition of shares, by the acquisition of assets or by a merger.

The most common form of acquisition is the purchase of shares. The sale of assets is mainly used in acquisitions pertaining to a business unit or divisions not organized in one or more separate legal entity(ies). Asset deals are also more frequent when it comes to the acquisition of real estate. Mergers are more frequently used for internal reorganization purposes, including in connection with post-acquisition integration, but can in certain circumstances also be used in acquisitions.

Auction processes are becoming more and more frequent in Switzerland. Such processes are typically administered by investment banks or other financial/M&A advisers, who put together the teaser, information memorandum and virtual data room, and organize procedural matters by way of process letters. In the course of the auction process, the bidders are initially requested to submit non-binding indicative bid letters and, at a later stage, so-called binding bid letters as well as a mark-up of the seller's draft SPA. Although referred to as "binding bid letters," these letters are very rarely legally binding under Swiss law. An auction process is usually used as a tool to put time pressure on the buyer to wrap up its due diligence in a very short period of time and to enable the seller and its advisers to compare the offers, not only in terms of pricing, but also in terms of warranties and covenants required by potential buyers.

The Merger Act contains specific rules on mergers. A merger is defined as the combining of all assets, liabilities and contractual obligations of two or more companies. There are two types of mergers in accordance with the Merger Act: (i) the absorption merger, where one company absorbs another — the transferring company being liquidated, and its assets and liabilities transferred to the absorbing company, and (ii) the combination merger, where all companies merge into a new company — all merging companies are liquidated and their assets and liabilities are transferred to a new company. The shareholders or quotaholders or other members in the transferring company generally become members in the absorbing company and the transferring company is dissolved.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

The main forms of corporate entity in Switzerland are:

- share corporations (*Aktiengesellschaft/AG; société anonyme/SA*; 'corporations'); and
- limited liability companies (*Gesellschaft mit beschränkter Haftung/GmbH; société à responsabilité limitée/Sàrl*, 'LLCs').

What are the different types of limited liability companies?

The two types of limited liability companies available under Swiss law are the share corporation (AG/SA) and the limited liability company (GmbH/Sàrl). Both company forms are quite similar. The minimum share capital required in the case of a share corporation is CHF 100,000 (of which, however, only CHF 50,000 must mandatorily be paid-in) and in the case of a limited liability company CHF 20,000 (which needs to be fully paid in). The shareholders of a limited liability company must be registered in the commercial register and thus become public, whereas the shareholders of a share corporation do not need to be disclosed in the commercial register. In general, the share corporation offers more flexibility to the shareholders than a limited liability company. For example, the minimum par value of a share in the case of a limited liability company must be at least CHF 100, while the minimum par value can be CHF 0.01 in the case of a share corporation. For this reason, the share corporation is typically used if certain flexibility is required with regard to the split of the share capital, such as in private equity set-ups. The limited liability in turn is often used by US groups as it allows a "check-the-box" election for US tax purposes, which is not possible with a share corporation.

Is there a restriction on shareholder numbers?

No, in Swiss limited liability companies ("**GmbH**") and share corporations ("**AG**"), the number of shareholders can be one or several.

What are the key features of a share sale and purchase?

An acquisition of shares (or 'share sale') is, from a transactional point of view, much simpler than an acquisition of assets, because (i) no individual transfers of title to the various assets of the target company are necessary and all the liabilities of the company are transferred with the target company without having to observe any special transfer formalities or to obtain any consent or release from creditors or (ii) no special formalities or registrations are required (as in case of a transfer of assets and liabilities under the Merger Act).

What are the key features of an asset sale and purchase?

Since the entry into force of the Merger Act on 1 July 2004, it has been possible to conduct sales and acquisitions of assets as:

- transfers of assets and liabilities under the Merger Act; or
- transfers of defined assets and liabilities under the Swiss Civil Code and the CO (a 'single transfer').

The advantage of the new regime under the Merger Act is that one single deed of transfer is sufficient for the assets and liabilities to be transferred by operation of law (as opposed to an acquisition of assets structured as a transfer of defined assets and liabilities in which the transfer of each and every asset and liability must be made in the form provided for in the Swiss Civil Code and the CO). The advantage of single transfers is that the buyer acquires only the liabilities listed in the agreement and transferred in that transaction. In addition, the terms of a single transfer of assets and liabilities can be kept confidential, while the documents governing a transfer of assets and liabilities under the Merger Act need to be filed with the commercial register, to which third parties may obtain access.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

It is common in Swiss transactions to execute a letter of intent or term sheet. A letter of intent or term sheet is usually not binding on the parties with the exception of specific provisions contained therein and explicitly referred to as binding, such as exclusivity, confidentiality, break fee, governing law and jurisdiction.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: A term sheet typically includes provisions on exclusivity.
- Break fee: A term sheet sometimes includes provisions on break fees. If a break fee is agreed, it is usually also included in the term sheet.
- Confidentiality: A term sheet typically includes provisions on confidentiality.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

If included in the term sheet, there are no separately negotiated agreements on confidentiality, exclusivity and break fees in addition. However, it is possible — and in particular with regard to confidentiality not uncommon — to execute a separate agreement that is already executed ahead of the term sheet. Typically, the term sheet would then refer to such separate agreement(s).

Is there a duty or obligation to negotiate in good faith?

Under Swiss law, and irrespective of the existence (and/or terms) of any document such as a letter of intent or a memorandum of understanding, entry into negotiations imposes certain duties on each party involved. In particular, each party has a general duty to negotiate in good faith, which may mean (for example) advising the other party about any decision not to pursue the transaction and not to continue negotiations in those circumstances.

While the conduct of negotiations does not in itself impose any duty to conclude an agreement or proceed with the contemplated transaction, a bad faith withdrawal from negotiations or other breaches of the pre-contractual duty to negotiate in good faith may cause the relevant party to be in breach of the requirement to act in good faith, so that the party in breach may be obliged to indemnify the other party for losses or damages that result from such breach. Note, however, that such indemnification would extend to costs incurred unnecessarily, as opposed to any lost profits or other potential losses. This form of pre-contractual liability is also known as the '*culpa in contrahendo*.'

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: fairly common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: cash free/debt free and working capital adjustment are very common. NAV adjustment is rarely seen.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually the buyer/target company.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely; frequently reviewed by an audit firm (i.e., accountants), but only occasionally audited.

Is an earn-out common?

Frequency/market practice: earn-outs are fairly common in private equity transactions, but less common in other transactions.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: fairly common, particularly with private individual sellers.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common.

Is the MAE general or specific?

Frequency/market practice: both are seen, but frequently specific following negotiation.

Is the MAE quantified?

Frequency/market practice: fairly common; increasingly seen.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: rarely; waterfall provisions uncommon. Under Swiss law, a judge may reduce scope of a non-compete clause to a legally permissible level.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: common (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: common (in conjunction with a non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; it is generally obtained in private deals. Note that there may be competition law issues around potential 'gun-jumping.'

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: rarely; if seen, it is often subject to the buyer's right to terminate.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen, but often not quantified (other than specific representations and warranties, e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers depend on risk-sharing in the deal, often qualified to best knowledge after due enquiry of a specified list of members of senior management.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: rarely.

Is disclosure of the data room common?

Frequency/market practice: very common; typically fair disclosure is standard.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common; repetition at completion is common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: no; only at signing and at closing.

Is a bring-down certificate at closing common?

Frequency/market practice: bring-down certificates are not very common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: fairly common; true and accurate is in all material respects common, but there is often a carve-out for fundamental representations and warranties, which must be absolutely true.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: this is reasonably common when representations and warranties are qualified by materiality thresholds.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: this is largely dependent on bargaining power, extent of due diligence and risk-sharing. The amount is typically 10%-30%, but also possibly up to 50%, subject to a higher cap for title and specific representations and warranties.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: they usually only apply to warranties.

What are the common exceptions to the cap?

Frequency/market practice: key representations and warranties are generally excepted (e.g., title, capitalization, authority). Often, tax and specific areas of concern are also excepted, sometimes with specific higher caps. Separate caps can be negotiated.

Is a deductible or basket common?

Frequency/market practice: deductible is more often resisted and a tipping basket is more common.

Is a *de minimis* common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: the general survival is 12-24 months; there are typically longer periods for title and tax than general representations and warranties. There may be a special duration for other representations and warranties on a case-by-case basis, e.g., on environmental issues.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: fraud is generally carved out (consistent with statutory law).

Is warranty insurance common?

Frequency/market practice: rarely; increasingly common, particularly in private equity exits.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common; common for amounts actually received.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common; common for amounts actually received.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: this is required by law for warranty damages, and usually incorporated in the purchase agreement.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: fairly common; part of the disclosure concept.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: Swiss law.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is still more common, frequently in Geneva or Zurich according to the rules of arbitration of the Swiss Chambers of Commerce (Swiss Rules of International Arbitration of the Swiss Chambers' Arbitration Institution).

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: this is negotiated on a case-by-case basis.

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: fairly common; a tax deed is uncommon.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Taiwan

Quick reference guide

Due diligence, pricing and closing

Signing/closing considerations

Is a deposit required?

The payment of a deposit may be required for share and asset deals in Taiwan.

Is simultaneous signing/closing common?

Signing and closing do not occur simultaneously due to the requirement to seek prior approval from the Investment Commission ("**IC**").

Approvals/registrations

Any investment by a foreign investor in a Taiwanese company, either by way of a transfer of shares or subscription for new shares, requires prior approval by the IC. It usually takes two to three weeks to obtain foreign investment approval, but if the value of the investment exceeds USD 50 million or if the transaction involves a merger or takeover, it could take two to three months to obtain approval.

Any investment by a Chinese investor in a Taiwanese company, whether via purchase of old shares or subscription of new shares, requires prior approval by the IC as well.

A "Chinese investor" is defined as an investor directly or indirectly owned 30% or more by Chinese persons or controlled by Chinese persons. As such, foreign investors always try to assert that they are not directly or indirectly 30% owned by Chinese persons or Chinese funded persons. Such practice inevitably discourages investment from Hong Kong or by a listed company (as it is not easyto ascertain its shareholding structure).

Merger control (antitrust/competition approval)

In Taiwan, a merger filing is required if:

(i) the transaction qualifies as a "business combination" under the Fair Trade Law ("**FTL**"), which generally refers to a merger, an acquisition of one-third of the shares or any other means for change of control; and

(ii) the parties' market status is significant enough.

When looking at the parties' market status, most jurisdictions adopt sales turnover thresholds but not the market share threshold because it is too difficult to define the relevant market and collect market data.

Taiwan, however, still adopts both the turnover thresholds and market share thresholds, meaning that if, after completion of the transaction, the parties will aggregately possesses one-third or more market share or any party has one-quarter market share, merger filing with the Taiwan Fair Trade Commission ("**TFTC**") will be required (assuming the transaction constitutes a "combination" under the FTL).

Limited fundraising instruments

The types of securities that can be issued by a Taiwanese private company are very limited (common shares, preferred shares and straight bonds). A private company cannot issue convertible bonds, exchangeable bonds, stock options or warrants from investors for fundraising.

Foreign exchange control

Taiwan's foreign exchange control regulations are very strict and the main regulator, the Central Bank of the Republic of China (Taiwan) ("**CBC**") is very powerful and quite conservative. If the investment or repatriation amount is big and may have a huge impact on the exchange rate of New Taiwan dollars, the CBC may limit the daily conversion quota (such as only USD 5 to 10 million per business day) or even ask the foreign investor to enter into a swap transaction, which may be costly.

The CBC could also ask the foreign investor to keep the foreign currency without converting into New Taiwan dollars, despite the transaction agreement that has been made between the foreign investor and the sellers.

Employment

Consents from employees are required during a merger, spin-off, 100% share swap or an asset/business transfer. If any of the employees do not consent to the transaction, the employer must pay severance and terminate the employment agreement.

Tax

N/A

Post-acquisition integration

N/A

Common deal structures

What are the key private M&A deal structures?

Mergers and acquisitions in Taiwan can be effected through an asset purchase, share purchase or merger. The Enterprise Merger Law ("**EML**") only applies to M&A between companies limited by shares ("**CLSs**") and mergers between CLSs and limited companies ("**LCs**") where the CLS becomes a surviving entity. The EML does not apply to M&A between LCs. The following provisions focus on the CLS, as it is the most commonly used by foreign investors.

There are two types of mergers: statutory merger and simple parent-subsidiary merger. A statutory merger of two companies limited by shares is possible under Article 316 of the Company Law or under Articles 18 to 21 of the EML. The surviving company can be one of the existing companies or it may be a new company but, in either case, it must be limited by shares. Statutory mergers offer a number of benefits. For instance, as a general rule, a statutory merger does not require any third-party consents or transfers. Additionally, following the enactment of the EML, statutory mergers have been generally accomplished with certain tax incentives (see below).

If the target company is to be liquidated after the acquisition of its shares or assets, a statutory merger is preferable as it will not attract indirect taxes related to transfer of assets. Further, the surviving entity can, in some cases, continue to enjoy the favorable tax attributes of the extinguished entity, such as exemption from income tax (e.g., for strategically important industries) and investment tax credits.

Regarding a simple parent-subsidiary merger, if an acquiring company owns 90% or more of the outstanding shares of a target company, the merger can be consummated following a simple approval from the boards of the merging companies, as there are fewer shareholders requiring protection since the major shareholders will be acquiring the company (Art. 19, EML). Article 316-2 of the Company Law provides similar procedures for simple parent-subsidiary mergers.

An auction process and bidding are not often seen.

The main process of the statutory merger involves conducting the board meeting and shareholders' meeting, executing the merger agreement, issuing a public notice and notifying creditors and contracting parties, notifying employees, close on the record date, and processing the company amendment registrations. If a party to the merger is an approved foreign invested company, prior approval from the Investment Commission is necessary.

Share purchases and statutory mergers are more common than asset purchases.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

The Company Law recognizes four types of locally incorporated companies. Two of these, companies limited by shares (CLSs) and limited companies (LCs), provide all shareholders with limited liability. The other two (both unlimited liability companies) result in greater shareholder liability and so are rarely used. Among the four business vehicles, a CLS is the most commonly used by foreign investors for M&A deals.

What are the different types of limited liability companies?

A limited company (LC) can have one or more shareholders. The capital of an LC is not divided into shares. Each shareholder of the LC holds the amount of capital contribution that the shareholder contributes to the capital of the LC.

Shareholders of an LC may transfer their 'capital contribution' upon the written consent of the majority of the other shareholders. Directors may transfer their capital contribution with the written consent of all other shareholders (or two-thirds of voting rights of other shareholders under the new Company Law that is expected to become effective in late 2018 or early 2019). A shareholder who does not consent to a transfer has a priority right to purchase the transferred capital. However, if the shareholder elects not to purchase the transferred capital, then he or she is deemed to have consented to the transfer. An LC must have one to three directors elected from the shareholders or persons other than the shareholders. If more than one director is appointed, a chairperson must also be elected. A vice-chairperson may also be elected. The chairperson and vice-chairperson need not be PRC nationals.

The names of the shareholders must be provided in the articles of incorporation. Each director or shareholder has one vote. However, the shareholder vote may be based on the amount of capital contribution if so provided in the articles of incorporation.

A company limited by shares (CLS) is a limited liability company with at least two shareholders (or sole corporate shareholder). The capital of the CLS is divided into shares. A CLS shall have at least three directors and one supervisor (one director and one supervisor are sufficient under the new Company Law that is expected to be effective in late 2018 or early 2019). The transfer of all or part of the shares by a shareholder does not need consent by the company or other shareholders, and other shareholders do not have a priority right to purchase shares to be transferred. The chairperson elected by and from the directors is the statutory representative of the CLS. A vice-chairman may also be elected. The chairperson and vice-chairman need not be PRC nationals.

The names of the shareholders do not need to be provided in the articles of incorporation. The voting right is based on the number of shares owned by a shareholder.

Is there a restriction on shareholder numbers?

There is no limitation on the number of shareholders of an LC or a CLS.

What are the key features of a share sale and purchase?

Under current law, share purchases may be effected by any of the following methods.

Traditional share purchase: Existing shares of a private company can generally be sold and purchased free of legal restrictions (although the seller may be restricted by contractual obligations towards third parties).

There is a 0.3% securities transaction tax and a 12% alternative minimum tax for corporate shareholders. The main drawback of a share purchase transaction is that it involves a sale of the target company together with all its liabilities, including contingent or undisclosed liabilities.

Statutory share swap: A company may acquire 100% of the outstanding shares of a target company by issuing new shares to swap with all of the target's outstanding shares (Art. 29, EML). The seller will be exempt from the 0.3% securities transaction tax.

What are the key features of an asset sale and purchase?

Unlike a share purchase, an asset purchase has historically involved a higher tax cost. While a traditional asset purchase is still viable in certain circumstances, the EML has broadened the landscape with other options.

Traditional asset purchase: Until recently, sellers were less inclined to agree to a traditional asset sale because this attracted higher tax costs. Buyers, however, preferred an asset purchase because the liabilities of the target were seldom automatically transferred and buyers could contractually exclude the transfer and assumption of specific assets or liabilities of the target company that they did not wish to assume. The prior consent of third parties may be required before certain assets or contracts of liabilities can be transferred. With the enactment of the EML, new options have emerged that are favorable to both parties, giving the buyer certain opportunities to pick and choose while keeping the seller's taxes low.

Statutory acquisition of assets: Statutory acquisition of assets is now permitted under Article 27 or 28 of the EML. These articles deal with the following transactions:

- a general assumption of assets and liabilities (as defined in Art. 305, Civil Code);
- a transfer of the whole or essential part of a company's assets or business (as defined in Art. 185(1)(ii), Company Law);
- the assumption of all of the assets or business of another company, which has a significant effect on the buyer's own business (as defined in Art. 185(1)(iii), Company Law); and
- a wholly owned subsidiary issuing new shares as consideration for the acquisition of the whole or essential part of the parent company's assets or business (as defined in Art. 28, EML).

Under the EML, consideration for an asset acquisition may be cash, shares and/or other assets.

The EML permits exemptions of VAT, deed tax, stamp duty, and securities transaction tax and deferral of land value increment tax for certain qualifying transactions.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

Yes, for larger companies or larger transactions.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: It is fairly common to include exclusivity provisions in term sheets.
- Break fee: Normally, the term sheet will provide that each party is responsible for its own fees and costs incurred if the transaction does not proceed due to reasons not attributable to a party.
- Confidentiality: It is fairly common to include confidentiality provisions in term sheets.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Before the definitive agreement is entered into, there may be an additional confidentiality agreement but it is not common to enter into separate agreements during this period. It is common for the definitive agreement to contain confidentiality provisions and supersede the term sheet.

Is there a duty or obligation to negotiate in good faith?

Yes. Before an agreement is concluded, a party may seek indemnification from the other party for the damages caused to the requesting party if the requesting party, without negligence, believes the agreement can be concluded, and such damages are caused by certain reasons that are attributable to the requested party's bad faith.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: fairly common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: cash free/debt free, working capital and NAV are all fairly common.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually the target company.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely.

Is an earn-out common?

Frequency/market practice: fairly common; earn-outs are more common in private equity transactions when the sellers continue to manage the target company after closing. They are less common where seller is completely exiting. Earn-outs are commonly capped.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: rarely.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common.

Is the MAE general or specific?

Frequency/market practice: usually general.

Is the MAE quantified?

Frequency/market practice: rarely.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: waterfall provisions, etc. are rarely used.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common (in conjunction with a non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: fairly common; the contents of the restrictions vary in transactions.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; we generally get this for private deals.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: rarely, unless there is a significant gap between signing and closing. Notification of breach is fairly common.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: materiality qualifiers are commonly seen but are often not quantified (other than specific warranties e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are growing. They are often limited to the actual knowledge and due enquiry of a specified list of senior management.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: rarely; sophisticated sellers try to omit this representation; but if pressured, it is limited to fraud or an intention to mislead.

Is disclosure of the data room common?

Frequency/market practice: fairly common.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common; repetition at completion is common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: fairly common.

Is a bring-down certificate at closing common?

Frequency/market practice: a bring-down certificate is common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate in all material respects is common but often carve out for fundamental representations which must be absolutely true.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely; double materiality is usually avoided.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: the buyer will ask for 100% but it is possible to negotiate down. Tax or specific areas of concern may be carved out from the limitation.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: both are seen regularly, depending on the parties' level of sophistication.

What are the common exceptions to the cap?

Frequency/market practice: key warranties are often excepted (e.g., title, capitalization, authority). Often, tax and specific areas of concern (environmental) are also excepted, sometimes with specific higher caps. Separate caps can be negotiated.

Is a deductible or basket common?

Frequency/market practice: it is fairly common to have these limitations.

Is a *de minimis* common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: a cap of 1.5-2 years is common. For tax, 5-7 years' liability is common.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: yes, mainly fraud, tax and environmental warranties.

Is warranty insurance common?

Frequency/market practice: rarely.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: rarely.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: rarely.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: rarely.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: this is not required by law, but sometimes incorporated in contracts by express terms.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: fairly common.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: Taiwanese law.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: both are common; if an offshore entity is involved in the transaction, it often requests arbitration outside Taiwan, e.g., in Singapore.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: each agreement holder is responsible for the stamp duty levied on the agreement. The stamp duty for a movable properties transfer agreement is TWD 12 per agreement. The stamp duty for a real property transfer agreement is 0.1% of the purchase price.

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: it is fairly common to have tax indemnity, usually included in the purchase agreement.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Thailand

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

Regulatory non-compliance is common in Thailand, and is typically seen in relation to real property (e.g., the construction or alteration of buildings without proper permission) or undertaking activities without proper licenses or permits.

Another common due diligence issue is the lack or incomplete information provided for review. This is often seen in missing title documents and corporate documents, such as the lack of a proper share register book or missing records of ownership of real property. This may render it difficult to verify the seller's ownership and title to the property being acquired. Even if documents are provided for review, there may be difficulties in verifying the authenticity of the title documents and whether they were duly issued by the relevant governmental bodies.

Tax is another issue that foreign buyers should consider carefully. For instance, often the target company may not have properly affixed stamp duties in certain material contracts or documents, or may not have properly submitted its tax returns.

If any of the foregoing issues are discovered during the due diligence process, the buyer usually requires the seller to rectify the issues prior to closing. If the issue is not rectifiable or too costly to be rectified, buyers may negotiate for specific indemnities, or if the non-compliance is material, especially those relating to ownership and title of real property, these issues may be deal breakers for foreign buyers. However, depending on the nature of the buyer and its risk appetite, some buyers may be willing to accept the risks.

As such, detailed due diligence is required, especially on the title documents of real properties, and clients must be kept informed of any risks discovered during the due diligence process.

Signing/closing considerations

Is a deposit required?

It is fairly common for a deposit to be given upon signing a share sale or an asset sale transaction in Thailand. A deposit may also be required upon signing a letter of intent before signing definitive transaction agreements. An escrow arrangement for a deposit is also common.

Is simultaneous signing/closing common?

Depending on the type of the transaction, there is usually a time period between signing and closing to fulfil the necessary conditions precedent. If there is a simultaneous signing/closing, parties usually specify closing deliverables and arrangements to reflect actions to be fulfilled by the seller and purchaser instead of conditions precedent.

Publish notice of shareholders' meeting

A notice to call a shareholders' meeting must be published in a local newspaper and sent to all shareholders by receipt-acknowledged mail. This requirement should be considered when making arrangements for signing/closing. A careful review of any possible additional requirements stipulated in the articles of association is also imperative.

Approvals/registrations

Foreign investment

Whether an approval or permission from the relevant regulatory body is required depends on the type of business that the foreigner intends to conduct and whether such business is a restricted business.

Restrictions under the Foreign Business Act

Generally, a foreigner may wholly own a business in Thailand unless the specific activity of such business is restricted or otherwise prohibited under the Foreign Business Act ("**FBA**") 1999. Companies are considered to be a "foreigner" for these purposes if 50% or more of their share capital is held by foreign individuals or juristic entities.

The prohibited or restricted businesses under the FBA are categorized in three schedules. If the intended business falls within Schedule 1 of the FBA (businesses not permitted for foreigners due to special reasons), these activities may not be undertaken by foreigners. Prohibited activities include land trading, newspaper, radio broadcasting or television businesses, animal farming, forestry, fishery in Thai waters and trading Thai antiques.

If the intended business falls under Schedule 2 of the FBA (businesses related to national security or affecting arts, culture and natural resources), a foreigner may engage in such business activities with permission from the Minister of Commerce, which requires a resolution of the Cabinet. Even if licensed, those foreign entities must include Thai nationals or entities holding at least 40% of their share capital.

If the intended business falls under Schedule 3 of the FBA (businesses such as accounting, retail and hotels regarding which Thai nationals are not yet ready to compete with foreigners), a foreigner may engage in such activities with permission from the director-general of the Department of Business Development and the Ministry of Commerce, with approval of the Foreign Business Board. If a foreign enterprise receives this permission, the foreign entity can be 100% foreign-owned and there is no requirement for a minimum number of Thai directors.

Exceptions

Exceptions to the FBA under the Treaty of Amity

Many restrictions under the FBA do not apply to American nationals or entities pursuant to the Treaty of Amity and Economic Relations 1996 between Thailand and the United States. The treaty allows US individuals and companies incorporated in the United States or Thailand that are majority owned and controlled by US nationals to largely conduct business in Thailand as if they were a Thai national (with the exception of certain specific businesses). Before undertaking any other restricted businesses, a US individual or entity must apply to the director-general of the Department of Business Development and the Ministry of Commerce for a foreign business certificate ("**FBC**") acknowledging the carrying on of that specific restricted business. The process of obtaining the FBC usually takes one month.

Exceptions to the FBA under the Board of Investment ("**BOI**") and Industrial Estate Authority ("**IEAT**") exceptions

Foreigners that have been granted investment promotion from the BOI or permission to operate industrial or export businesses by the IEAT in relation to businesses described in Schedules 2 and 3 will also be exempt from the FBA. In this respect, they must notify the Ministry of Commerce and procure a certificate from the director-general, who will issue the certificate within 30 days from the date of receiving the notification.

Restrictions under the Land Code

The Land Code B.E. 2497 (A.D. 1954) generally provides that land may only be owned by Thai nationals or companies in which Thai nationals own 51% or more of the registered share capital and more than half the number of its shareholders are Thai nationals.

Other restrictions

In addition to the FBA, several statutes impose conditions of majority ownership and management by Thai nationals in specific business sectors, including land ownership, financial institutions, insurance, telecommunication and shipping. These statutes also impose specific approval requirements from the relevant regulatory bodies.

Merger control (antitrust/competition approval)

Approvals for share acquisitions and asset acquisitions may be required under the Trade Competition Act 2017.

Mergers and acquisitions that may result in the lessening of competition in a market in a significant way, as per the criteria prescribed by the Trade Competition Commission, must notify such merger to the Trade Competition within seven days post-completion of the transaction. Mergers and acquisitions that may result in a monopoly or in a dominant position must receive pre-merger clearance from the Trade Competition Commission.

In addition, there are specific filing requirements for mergers or acquisitions that would create a monopoly or lead to unfair competition under specific laws relating to specific industries, such as the energy and telecom sectors.

Other regulatory or government approvals

Mergers and acquisitions related to specific businesses, such as insurance and financial institutions, have specific regulatory approval requirements.

Employment

In share acquisitions, the target company, as the employer, continues to be the employer of its employees and there is no requirement to obtain employee consents.

If there is an asset sale and employees form part of in-scope assets, the transfer of employment does not take place automatically, and employee consents will have to be obtained. Without employee consents, the employees will remain the employees of the seller and if their employment is terminated by the selling company, then the terminated employees will be entitled to statutory payments upon termination, including severance pay.

At the time of the transfer of employment, the transferee is required to assume all rights and obligations of the transferred employees from the transferor.

Tax

In an acquisition of shares, stamp duty is payable on the original share transfer instrument at the rate of 0.1% of the sale price or the paid-up value of the shares, whichever is higher.

For an acquisition of immovable property, there is a registration fee at the rate of 2% of the official appraised value of the assets announced by the Land Department and a specific business tax at the rate of 3.3% of the higher of:

(i) the official appraised value announced by the Land Department; or

(ii) the purchase price,

and withholding tax at the rate of 1% of the higher of:

(i) the official appraised value announced by the Land Department; or

(ii) the purchase price.

For an acquisition of moveable assets or intangible assets (e.g. intellectual property and goodwill), there is a VAT of 7% of the sale price of the assets and withholding tax at 3% for the sale of intangible assets.

Post-acquisition integration

Issues with post-acquisition integration are generally practical issues, such as post-closing calculation and adjustment of the purchase price. If the buyer is new to the business or new to Thailand, the buyer may need some assistance from the seller during the transition period and these transitional services are usually negotiated alongside the sale and purchase agreement.

Common deal structures

What are the key private M&A deal structures?

There are three main forms of M&A recognized in Thailand. Strictly speaking, the concept of 'merger' is not recognized under Thai law, but rather the concept of 'amalgamation.' For the purposes of this publication, the term 'merger' will be used. Mergers and acquisitions can take the form of an:

- amalgamation or a consolidation;
- acquisition of the shares in a target company; or
- acquisition of assets of the target company.

In addition to these three main forms, there are also some situations where, for commercial reasons, a combination of acquisitions is necessary. For instance, the transaction may begin with a share acquisition to acquire an entire entity, and is then followed by an amalgamation or asset acquisition to transfer all or a part of the assets to the acquiring entity.

An auction process is becoming popular, especially for attractive businesses. Indicative bid process letters are commonly used at the first offer stage.

Merger procedures are considered to be complex and relatively time-consuming, which means acquisitions of shares or of assets are generally more common in Thailand than merger procedures.

Under Thai laws, once two or more companies are merged, the merged company will become a new company and the merging companies will lose their legal personality. The new company will inherit all of the assets, liabilities, rights, duties and responsibilities of the merging companies.

In addition, major drawbacks of merger are that the new corporation loses the opportunity to treat the net loss of the original corporation as an expense when computing net profit for tax purposes, and the transaction may involve several complicated, time-consuming legal procedures.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

The nature and form of limited liability companies in Thailand are essentially the same as in many other jurisdictions. The capital is divided equally and is represented by shares in a designated (par) value. The liability of each shareholder is limited to the unpaid portion of the shares held. Limited liability companies may be either private companies, which are subject to the CCC, or public companies, which are subject to the PLC Act.

What are the different types of limited liability companies?

There are two types of limited liability companies i.e., a private limited company and a public limited company.

Is there a restriction on shareholder numbers?

To establish a private limited company, at least three natural persons (not necessarily Thai citizens) must act as promoters (founders), with each holding at least one share, thus becoming a shareholder upon incorporation. The par value of a share of a private limited company is at least THB 5 and each share must be at least 25% paid up. There is no maximum number of shareholders. For a public company, there must be at least 15 promoters for the incorporation of a company.

What are the key features of a share sale and purchase?

In a share acquisition, a potential acquirer seeks to buy a majority share in the acquired company (or effect a takeover). Both acquiring and acquired entities survive, but the acquired entity becomes a subsidiary of the acquiring entity.

What are the key features of an asset sale and purchase?

In an asset acquisition, both the acquiring and the acquired entities survive. The acquired entity merely divests its assets or business(es) and transfers them to the acquiring entity. After completion of the transaction, whether the acquired company is dissolved or is maintained to carry out different business activities can be considered as a separate issue.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

Depending on the transaction, the M&A process typically starts with the identification of assets, determination of the most appropriate acquisition vehicle, and preparation of preliminary documents. Those documents (e.g., non-disclosure and confidentiality agreements, memorandum of understanding and letters of intent) specify obligations of the parties to the transaction and often key terms and conditions of the acquisition agreements. Whether such documents form a contract or legally bind the parties to them depends on their own terms.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: Depending on the size of the transaction, it is fairly common to have exclusivity provisions in a term sheet.
- Break fee: It is not common to have a break fee provision in a term sheet.
- Confidentiality: Depending on the size of the transaction, it is fairly common to have confidentiality provisions in a term sheet.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

These are usually included in the share purchase agreement.

Is there a duty or obligation to negotiate in good faith?

There is a general provision under Thai laws that every person must, in the exercise of his/her rights and in the performance of his/her obligations, act in good faith. The amount of damages will be determined by the Thai court.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: very common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: cash free/debt free and working capital are very common. NAV is also common.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually prepared by the target company (but the buyer may be involved in process of preparing the accounts).

Is the balance sheet audited (where applicable)?

Frequency/market practice: very common; yes and the audited balance sheet must be submitted to the authority.

Is an earn-out common?

Frequency/market practice: fairly common; earn-outs are more common in private equity transactions when the sellers continue to manage the target company after closing. They are less common where the seller is completely exiting. Earn-outs are commonly capped.

Is a deposit common?

Frequency/market practice: fairly common; usually, it depends on the bargaining of the seller.

Is an escrow common?

Frequency/market practice: fairly common.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common.

Is the MAE general or specific?

Frequency/market practice: both are seen.

Is the MAE quantified?

Frequency/market practice: fairly common.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: waterfall provisions are rarely used.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common (in conjunction with a non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; we generally get this for private deals.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: fairly common; updating schedules is common but limited to things like lists of contracts. Notification of possible breach is common. Where there is a material breach, there is a right to terminate.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers and quantified amounts are commonly seen.

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are growing. They are often limited to actual knowledge and due enquiry of a specified list of senior management.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: very common; it is always requested by buyers, but is typically one of the most contested warranties.

Is disclosure of the data room common?

Frequency/market practice: fairly common.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common; repetition at completion is common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: fairly common.

Is a bring-down certificate at closing common?

Frequency/market practice: bring-down certificates are not very common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate in all material respects is common but often carve out for fundamental representations which must be absolutely true.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely; double materiality is usually avoided.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: the cap is more buyer-friendly. We usually end up with a cap at the purchase price. Key warranties are usually unlimited or higher than general warranties.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: both are seen regularly.

What are the common exceptions to the cap?

Frequency/market practice: key warranties often excepted (e.g., title, capitalization, authority). Often tax and specific areas of concern, sometimes with specific higher caps. Separate caps can be negotiated.

Is a deductible or basket common?

Frequency/market practice: fairly common.

Is a de minimis common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: this is commonly 1-3 years. Tax negotiations start at 10 years but often end up at around five years. Fraud warranty is normally unlimited.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: fairly common.

Is warranty insurance common?

Frequency/market practice: rarely; we are starting to see it in private equity exits.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: rarely.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common for actually received.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common for actually received.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: this is not usually stipulated in the purchase agreement.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: rarely; often silent.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: a choice of foreign law is permissible, unless it is contrary to public policy. Thai law is more common.

What is the common governing law?

Frequency/market practice: this is determined on a case-by-case basis.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is more common especially in Singapore.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: there is a stamp duty if signing or bringing original share transfer document into Thailand, which is 0.1% of paid-up value or of purchase price, whichever is higher. Unless agreed otherwise, the seller is responsible for stamp duty payment. The parties can agree that the buyer is solely responsible for stamp duty payment or the stamp duty be shared between both parties.

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: it is fairly common to have tax indemnity, usually included in the purchase agreement.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

United Arab Emirates

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

Due diligence in the UAE typically completes before execution of the acquisition agreement(s). The amount and quality of due diligence documentation can vary quite widely, depending on a number of factors, such as whether the seller structures the transaction as a direct sale or an auction sale, as well as the bargaining position of the parties. When issues are identified during the due diligence process, it is common to ask the seller to rectify the issue before closing. It is also common for the buyer to seek protection through a reduction in (or retention of) the purchase price or a specific indemnity covering the contingency.

The most common due diligence issues that a foreign investor should be aware of in the UAE relate to foreign ownership restrictions under UAE laws, licensing, employment, litigation and compliance. With the introduction of VAT on 1 January 2018, tax is now an additional focus area that must be borne in mind when conducting due diligence.

Payment

There are no legal requirements regarding pricing and payment of consideration. Payment does not need to be made locally in the UAE. Valuations are not required, save in limited circumstances (for example, pursuant to a statutory merger) or where there is an exercise of a purchaser of shares under a pre-emption right.

Wire transfers of funds are common and there are no foreign exchange controls. Due to local share transfer requirements, the use of escrow accounts to hold consideration payments is common.

Signing/closing

Share sale

A share purchase in the UAE will share many commonalities with share purchases in other jurisdictions. The key transactional document will be the long-form share purchase agreement (the "**SPA**") that sets out the full terms of the transaction.

An SPA can be drafted in English, does not have to be notarized and the parties can sign the signature page without having to sign or initial each page of the SPA. The SPA can be subject to UAE or foreign law. English law is usually used on cross-border transactions and some purely local transactions. It is generally acceptable for SPAs to be signed in electronic form under UAE law, provided that certain requirements are met with respect to verification of signature.

In order to implement the transfer of shares in a limited liability company ("**LLC**") (the form of entity that is most commonly used), a separate short-form Arabic language share transfer agreement is required. If the share transfer agreement is drafted in bilingual form (i.e., in Arabic and any other language, usually English), it must be attested by a sworn translator in the UAE before the existing and new shareholders of the company must then sign it before a notary public. The notary publics in certain Emirates have recently introduced the option to execute certain documents before a notary public via a video-conferencing facility rather than in person in certain circumstances.

In addition to the share transfer agreement, a schedule of amendment to the entity's existing memorandum of association must also be signed before a notary public. The attested, signed and notarized documents must then be submitted to the Department of Economic Development (the "**DED**") in the relevant emirate. The DED will update the commercial license of the company and issue a new license stating the names of the new shareholders with their respective shareholding. The share transfer agreement and the schedule of amendment of the articles of association may also be combined into one document if preferred.

If a buyer of shares is itself a corporate entity, the DED and notary public will require the constitutional documents of the buyer to be submitted to it for review, along with a shareholder or board resolution (as the constitutional documents of that company requires) resolving to acquire the shares and to appoint a signatory to sign the share transfer documents before the notary public, and any other relevant documents that may be required to obtain external approval from other regulators.

Where the buyer is a foreign entity, the buyer's constitutional documents and buyer resolution must be legalized by the UAE Embassy in the country of origin of the buyer, attested at the Ministry of Foreign Affairs in the UAE, and then translated into Arabic and attested by a sworn translator in the UAE. Where the buyer is an entity that is incorporated in the UAE, an original or attested copy will suffice for the purposes of submission to the DED and the notary public.

For companies that are registered in one of the many free zones in the UAE, similar documents are required to effect a transfer of shares, with the exception that: (i) the existing shareholders and the buyer must sign the transfer documents before the relevant free zone authority rather than signing the share transfer agreement before a notary public; and (ii) the constitutional documents of the target company and the buyer and seller resolutions do not usually need to be translated into Arabic.

Shareholders of an LLC have statutory rights of pre-emption on all transfers of shares in that LLC which would need to be waived by any remaining shareholders in order to implement the share transfer.

Asset sale

An asset purchase in the UAE will share many features of asset purchases in other jurisdictions. The key transactional document is the long-form asset purchase agreement (the "**APA**"). The APA does not need to be submitted before any authorities and may therefore be drafted in the language preferred by the parties. The APA may also be signed electronically if this approach is preferred by the parties.

Unless the assets to be transferred are of a type that are registered, there is no need to file any documentation with the relevant authorities. If registered assets are to be transferred, the parties would typically execute a short-form document to that effect rather than filing the long-form APA that contains the full terms of the transaction with the authorities.

Movable assets may be transferred between parties without concluding a sales contract. It can instead be effected through a purchase order. Certain types of registered assets may require a separate transfer agreement to be entered into or a procedure to be followed. Such assets include (without limitation) real estate, motor vehicles, employees and registered intellectual property.

Approvals/registrations

Foreign investment

As a general rule, the UAE imposes restrictions on shareholding by foreign investors in companies which are incorporated onshore in the UAE, with such companies typically being required to have at least 51% of their shareholding held by either a UAE national or another UAE entity which is wholly owned by UAE nationals.

However, the recently adopted Federal Law No. 19 of 2018, together with the implementing regulations contained in Federal Cabinet Resolution No. 16 of 2020, (collectively referred to hereinafter as the "**FDI Law**") provide a framework and have introduced sectors where foreign investors may hold up to 100% of the shares in a UAE mainland entity where certain conditions are met.

Foreign investors whose activities fit within the relevant sectors of the FDI Law would need to obtain an approval from the UAE's Foreign Direct Investment Committee (the "**Committee**") to own 100% of the shares in a mainland entity. When considering the decision, the Committee would likely take into consideration (among other factors) the existing relationship with the entity's existing local shareholder (if applicable) and the economic benefit of having an entity with the proposed activity in the UAE. It is worth noting however that under the FDI Law, any foreign entity benefiting from the Committee's approval must still engage a "local sponsor" (whose role is similar to that of a local service agent for a mainland branch) who would assist in the day-to-day government relationship of the entity but have no involvement in its operation nor have the ability to control or manage the affairs of the UAE entity.

In addition, UAE entities incorporated in free zones may, in certain circumstances, also benefit from obtaining a "dual-license", which would essentially allow the free zone entity to extend its operations to the UAE mainland through the registration of an onshore branch. For the time being, this option is only open to companies conducting certain limited types of business activities and which are incorporated into certain free zones.

Alternative transaction structures include genuine co-investments with a UAE national or the use of a nominee shareholder (who would be either a UAE national or a UAE corporate nominee service provider (a "**Nominee**")). Nominees commonly hold 51% of the legal title to the shares on behalf of a foreign shareholder with economic ownership and management control remaining with the foreign shareholder.

The UAE has implemented a policy that permits 100% ownership of UAE companies by individuals or companies from the GCC. This policy is widely adopted, although its precise scope is unclear and it is left to the discretion of the individual corporate registration departments of the relevant Emirate to implement.

A civil company formed under Federal Law No. 5 of 1985 (the "**Civil Code**"), can be 100% foreign-owned but shareholding in that company is normally limited to individuals (and is therefore of limited use to multi-national corporate groups).

Merger control

Approval from the UAE's recently created competition authority is required if an "*economic concentration*" is created. This is stated to be where the market share of the combined establishments exceeds 40% of the total "*transactions in the relevant market*", which is generally considered to refer to total revenue.

The regime has suspensory effect and the authority has 90 days to respond to the written application of the parties, which can be extended by a further 45 days. No response in this frame means that the transaction is approved.

Exceptions apply in respect of SMEs, certain sectors and government-controlled entities.

Other regulatory or government approvals

The requirement for regulatory or government approvals varies depending on the sector, the industry and whether the target company or assets are located onshore in the UAE or within one of the UAE's many free zones. Approval will always be required from the relevant authority to transfer shares and such approval may be further conditioned on obtaining approvals from additional government departments.

Employment

Share sale: All employees who are employed by the target group would remain employed by the target company upon closing of the transfer of shares, and all employment contracts and immigration permissions would therefore remain in place

It may be the case that one or more employees of the seller's group are not technically employed by the target group but perform certain employment functions in relation to the target group. If any such employees are intended to be transferred as part of the share sale transaction, the parties would need to apply the same approach for transferring those employees as that of the asset sale arrangement referred to below.

Asset sale: Employees transfer from the seller to the buyer under an asset sale by way of termination and rehire. New employment contracts will need to be entered into with each of the employees and new immigration permissions will need to be obtained in order to obtain a visa under the sponsorship of the buyer. If any employees refuse to agree to the transfer of their employment, they will remain employed by the seller unless and until their employment contracts are terminated or the employee resigns.

There is no obligation on the buyer to replicate the terms and conditions of the transferring employees, subject to any contractual obligation to do so that might be imposed under the transaction documents. However, employees are likely to be reluctant to agree to the transfer if they deem their new employment contracts to be less favorable to them. Although termination triggers the obligation to make all termination payments due to the transferring employees, it is common for the seller, the buyer and the employees to contractually agree to the rollover of the accruals and benefits to the new employment arrangement. This may require an adjustment to be made to the purchase price to reflect the rollover of these benefits.

There is no formal obligation to inform and consult with employees in either a share sale or an asset sale. However, such consultation is required in practice in relation to an asset sale, since the employment arrangement cannot be transferred in that case without the cooperation of the employee.

There is little in the way of legal guidance regulating the transfer of employees pursuant to corporate transaction. There is one reference in Federal Law No. 8 of 1980 (the "**Labor Law**") referring to current employment contracts remaining in place in the event of a "change in the form or legal status" of an establishment, and requiring both the new and old employers to be jointly liable for the employees for six month post transfer. However, we rarely see this provision being applied or relied on in practice. This provision is unlikely to apply in an asset sale (given the requirement to terminate and rehire the employees). Further, the proportioning of liability is normally dealt with in the transaction documents which typically provide that the seller is liable for any breach that it incurs up to the date of closing, with the buyer becoming responsible for any breaches that are incurred thereafter.

Tax

There is no stamp duty or capital transfer tax in the UAE. Registration fees are payable to the Municipality on the transfer of real estate.

Income tax is currently not imposed, except on the income of oil and gas producing companies and branches of foreign banks. There is no capital gains tax.

There is no personal income tax on individuals.

Value added tax is due at 5% on the transfers of assets in certain circumstances (but not on shares). The transfer of a business as a going concern is, however, outside the scope of VAT.

There is no withholding tax on the remittance of funds (within or outside the UAE).

Post-acquisition integration

It is critical to plan for post-acquisition integration well in advance of closing, particularly in the case of asset deals or regulated business requiring specific registrations.

A comprehensive plan covering all aspects of integration, including IT, HR, customer communications, compliance and tax, should be prepared and, where necessary, agreed with the seller in order to ensure maximum value is captured by the buyer.

Matters such as amending regulatory permits, changing bank signatories, replacing security cheques or bank guarantees can be administratively burdensome and time consuming, and so agreement for transitional measures should be considered to ensure efficient continued operations.

Common deal structures

What are the key private M&A deal structures?

In the UAE, transactions are usually concluded via either a share purchase or an asset purchase. Statutory mergers can also be concluded under UAE law, but are not commonly used.

Auctions are not uncommon in the UAE. Bid process letters are commonly used and often require binding offers to be submitted, although such binding offers are usually drafted to be highly conditional and are therefore unlikely to have a binding effect.

Federal Law No. 2 of 2015 (the "**CCL**") provides for the merger of UAE companies by way of amalgamation (where two companies merge by disappearing into one newly formed company) and absorption (where one company merges into another such that only the merged company survives). These provisions are complex, largely untested and therefore not generally used in the context of private company M&A transactions. However, mergers are increasingly being used in the context of restructuring transactions, where there is less likelihood of a dispute in the absence of clear regulations. Certain well-established free zones (such as the Dubai International Financial Centre ("**DIFC**") and the Abu Dhabi Global Market ("**ADGM**")) also have fairly robust regulations regarding mergers and amalgamations, although this is not the case with all free zones (such as Dubai Airport Free Zone ("**DAFZA**") or Jebel Ali Free Zone ("**JAFZA**") for instance).

What types of corporate entities are available in the UAE?

Corporate entities may be formed onshore in the UAE under either the CCL or the Civil Code.

The CCL provides for five different types of corporate forms: the LLC; the private joint stock company; the public joint stock company; partnerships; and foreign companies. In the context of private M&A transactions, the most common form of company incorporated onshore in the UAE is the LLC.

The Civil Code provides for an additional form of entity, being a civil company that undertakes 'professional' or 'consultancy' activities such as law firms, architecture, engineering and accounting firms. However, civil companies are rarely used for two reasons: (i) they do not have a separate legal identity and it is therefore not possible to ring-fence liability using such form of entity; and (ii) civil companies are not generally permitted to have corporate shareholders and are therefore not usually suitable for use as part of a multinational corporate group.

In addition to corporate entities formed onshore, corporate entities may be established in one of the many free zones in the UAE provided that the business activities of the company are of a nature that can be performed from within the confines of the relevant free zone. The DIFC and ADGM uniquely apply common law based on English law. The DIFC has been set up as a global financial center within the UAE as part of a broader Dubai strategy to increase its profile as a leading regional financial hub. The aim is to attract global and regional financial institutions, companies and service providers to operate in the DIFC. The ADGM was recently established and is broadly similar to the DIFC in many respects.

What are the key features of an LLC?

The LLC structure offers limited liability to its shareholders and provides that the number of shareholders must be a minimum of two and a maximum of 50. However, it is possible to form an LLC with a single UAE or Gulf Cooperation Council ("**GCC**") shareholder, whether natural or corporate.

The CCL does not prescribe a minimum capitalization for an LLC. However, there must be sufficient share capital for the realization of the objectives of the company. This will be judged by the relevant emirate-level authority that will regulate the incorporation of the company (for example, in Dubai it is the Dubai Department of Economic Development).

Onshore LLCs are not currently permitted to have different classes of shares (although a number of free zones now provide for different classes of shares, such as ADGM, DIFC and the Dubai Multi Commodities Centre (DMCC)). Government regulations can impose higher minimum capital requirements with respect to certain classes of company or types of activity.

The UAE's foreign ownership restrictions currently mean that a foreign party can only ever hold 49% or less in an LLC, unless such party is able to benefit from 100% ownership rights under the FDI Law. Under the FDI Law, a foreign investor may obtain an exemption to own up to 100% of an LLC, provided that certain criteria are met. Such criteria are assessed on a case-by-case basis by the relevant regulator in each Emirate.

Despite the foreign ownership restrictions, the LLC structure is flexible so that appropriate safeguards for the minority party can be included in the registered constitutive documents of the LLC (referred to as a 'contract of establishment' or a 'memorandum of association').

In addition to certain limited statutory protections (e.g., pre-emptive rights on issues of new shares), minority protections can include:

- supermajority voting;
- management control;
- disproportionate allocation of profits; and
- shareholding agreements and other contractual arrangements that supplement the memorandum and articles of association.

Is there a restriction on shareholder numbers?

There is a maximum of 50 shareholders for a limited liability company.

What are the key features of a share sale and purchase?

In the UAE, transactions are usually concluded via either a share purchase or an asset purchase. Statutory mergers can also be concluded under UAE law, but are not commonly used.

A share purchase in the UAE will share many features of share purchases in other jurisdictions. The key transactional document is the SPA and will commonly follow the UK style of drafting. This does not need to be submitted before any authorities and can therefore be drafted in the language preferred by the parties, but English is most common. SPAs will include terms commonly found in all jurisdictions, such as covenants, conditions, warranties and indemnities. The UAE enacted a competition law in 2012 and issued implementing regulations in 2014, so competition clearance is commonly included as a condition if the relevant market threshold test is met. The UAE introduced VAT on 1 January 2018 and so tax warranties and covenants are also being routinely included. The precise share transfer mechanics vary quite widely between the different company types, emirate of incorporation or relevant free zone, and often mean that an escrow is used to hold the consideration payment. Other documents such as a disclosure letter, transition service agreement or shareholders agreements will be similar to those used in other jurisdictions.

What are the key features of an asset sale and purchase?

An asset purchase in the UAE will share many features of asset purchases in other jurisdictions. The key transactional document is the APA. This does not need to be submitted before any authorities and can therefore be drafted in the language preferred by the parties.

Unless the assets to be transferred are of a type that are registered (e.g., registered trademarks, motor vehicles, real estate, etc.), there is no need to file any documentation with the relevant authorities. If registered assets are to be transferred, the parties would typically execute a short-form document to that effect rather than filing the long-form APA that contains the full terms of the transaction with the authorities.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

It is customary to prepare a letter of intent (commonly also referred to as a term sheet/MOU). The main commercial terms are commonly non-binding with certain of the boilerplate terms (costs, confidentiality, exclusivity, governing law and submission to jurisdiction) usually expressed to be binding. Offer letters in auction scenarios are commonly expressed to be binding but are rarely in fact binding due to the level of conditionality of the offer.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

Exclusivity: It is customary to include provisions on exclusivity.

Break fee: It relatively uncommon but not unheard of to include a break fee.

Confidentiality: It is customary to include provisions on confidentiality.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Exclusivity, break fee(s) and confidentiality can be either dealt with in separate agreements or wrapped together in a term sheet. There is no specific legal reason for this; it is usually a question of timing.

Is there a duty or obligation to negotiate in good faith?

Existence of a contract

In the absence of a contractual relationship, there is no duty on the parties to negotiate in good faith under UAE law.

However, even if a purchase agreement has not been entered into, a contract may be deemed to have already been entered into if:

- the essential elements of the contract are agreed between the parties;
- the details of the contract are defined or capable of being defined at a later stage; and
- the purpose of the contract is lawful (Art. 129, Civil Code).

If these elements are established, a contractual relationship can be inferred between the parties even if the contract has not been executed. If the parties do not want their contract to be qualified as binding, it is important to make an express stipulation to that effect.

Duty of good faith in UAE contracts

If the existence of the purchase agreement can be inferred subject to the above conditions, the parties have a duty to conduct themselves in a manner that is consistent with the principle of good faith under UAE law. Generally, the principle of good faith is defined as a negative obligation, i.e., a party should not act in bad faith or in a way so as to seek unfair advantage or to exploit the other. Conversely, a party would be seen to be acting in good faith if it is cooperative and, if possible, seeking to avoid conflict.

While the principle of good faith is certainly recognized, it may be difficult for a party to demonstrate that failure to sign a purchase agreement is an act of bad faith (or a lack of good faith), as there may be a number of other considerations at play. UAE courts will have ultimate discretion in determining whether damages commensurate with the time and money expended in connection with the purchase agreement can be awarded.

Termination for misrepresentation

Parties have the right to terminate a contract if the other party makes a misrepresentation and the contract has been entered into by a 'gross cheat' (Art. 187, Civil Code). Deliberate silence about a fact or circumstance will be treated as a misrepresentation if it is proved that the person misled the other and thereby would not have agreed to the contract if aware of that fact or circumstance (Art. 186, Civil Code).

Although the courts are not bound to adhere to case precedents under UAE law, they do have persuasive value and, in the past, UAE courts have established the following factors as to how liability should be determined under Article 187:

- it is necessary to prove that there has been both a 'misrepresentation' and a 'gross cheat';
- for a 'gross cheat' to be found, there must be a serious discrepancy between the true value of the thing sold and the price for which the buyer is buying it, to the extent that the victim would not have entered into the contract if the 'gross cheat' had not occurred; and
- the burden of proving that there has been a 'gross cheat' lies with the party making that allegation.

Depending on the facts of the case, the above provisions could be used to imply an obligation to disclose material information even where the seller has not specifically been asked to confirm the same as part of the due diligence process.

However, as this is ultimately at the discretion of the courts, it is recommended that buyers do not rely solely on this provision and try to make the due diligence questionnaire process as comprehensive as possible.

Sellers, on the other hand, should be cautious of this provision and note the risk that there may be liability issues if any relevant facts are not disclosed that they might be obliged to disclose under this obligation of good faith.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: fairly common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: cash free/debt free and working capital are fairly common. Net asset value ("**NAV**") and locked box mechanisms are becoming more common.

Is there a collar on the purchase price adjustment?

Frequency/market practice: sometimes.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: it depends on the negotiating strength of the respective parties, but it is more commonly the buyer.

Is the balance sheet audited (where applicable)?

Frequency/market practice: not usually, although sometimes the balance sheet is audited on medium-sized and large deals.

Is an earn-out common?

Frequency/market practice: fairly common.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: very common; share transfers usually require multiple steps and so they are commonly used as a completion mechanic to ensure that payment is made at completion.

Is a break fee common?

Frequency/market practice: not common, but is agreed to on occasion.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: becoming more common, although resisted by sellers; this is more common where there is a long period between signing and completion and is usually heavily qualified and limited to very specific events.

Is the MAE general or specific?

Frequency/market practice: both seen.

Is the MAE quantified?

Frequency/market practice: common, for example, by reference to a percentage downtown in revenue or EBITDA

Covenants

Is a non-compete common?

Frequency/market practice: very common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: waterfall/blue pencil provisions are fairly common, depending on the terms incorporated into the contract (for example, the jurisdiction applied to the acquisition agreement and the incorporation of an appropriate severance provision).

Are non-solicitation provisions (of employees) common?

Frequency/market practice: very common (in conjunction with a non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: very common (in conjunction with a non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: very common for private deals.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: notification of a warranty breach prior to closing is very common, with the right for the buyer to terminate or proceed to closing and seek damages in the circumstances. The right to issue additional disclosures prior to closing is less common, depending on the nature of the warranties against which the disclosure is to be provided.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: very common; materiality qualifiers are commonly seen but often not quantified (other than specific warranties, e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge is often qualified (frequently by reference to a specific group).

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common.

Is disclosure of the data room common?

Frequency/market practice: fairly common.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: very common; this is highly dependent on the strength of the respective parties' bargaining position but, if permitted, it is common to only repeat at closing with no bring-down certificate.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: fairly common.

Is a bring-down certificate at closing common?

Frequency/market practice: rarely.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate in all material respects is common but often carve out for fundamental representations which must be absolutely true.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: anywhere between 20%-80%, and sometimes even higher if the circumstances permit.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: usually warranties only. Sometimes the limitations will also apply to indemnities, but this is less common.

What are the common exceptions to the cap?

Frequency/market practice: key warranties are often excepted (e.g., title, capitalization, authority). Often tax and specific areas of concern, sometimes with specific higher caps. Separate caps can be negotiated.

Is a deductible or basket common?

Frequency/market practice: very common.

Is a de minimis common?

Frequency/market practice: very common.

How long does seller liability survive?

Frequency/market practice: it survives for 12-36 months (usually at least one full audit cycle under the buyer's ownership) for general representations and warranties, except for tax (if applicable), fundamental warranties and/or specific indemnities.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: it is common to carve out fraud and misrepresentation. Fundamental warranties are often carved out as well, depending on the circumstances and the liability cap agreed. The liability period for tax warranties is typically longer than the liability period for general warranties.

Is warranty insurance common?

Frequency/market practice: rarely.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: rarely; tax indemnities only really started being used in the UAE since the introduction of VAT on 1 January 2018 so there is not really an established market practice for this at the moment.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: very common for any insurance proceeds that are actually received.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: very common for any third party recoveries that are actually received.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: under UAE law, a party that contributes to a loss cannot claim damages for such loss, therefore implying a duty to mitigate. It is nonetheless common to include a contractual duty to mitigate loss in the purchase agreement.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: fairly common.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: UAE law is common for purchase agreements between two UAE-based parties. English law is commonly used for cross-border transactions and transactions involving foreign parties.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration in the Dubai International Financial Centre or overseas jurisdictions is commonplace and recommended as awards can generally be enforced without a local court rehearing the case. Foreign courts are rarely used as a forum for dispute resolution due to the issues of enforcement of foreign court orders in the UAE.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: no stamp duty is payable. Notarization fees for the transfer of shares in a limited liability company are paid by each party.

Is a separate tax covenant / indemnity or tax deed common?

Frequency/market practice: very common; tax indemnities and warranties are increasingly being used in the UAE since the introduction of VAT on 1 January 2018. They are usually included in the SPA and are relatively short form in comparison to other jurisdictions.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

Baker McKenzie.

Guide to Navigating Global Private M&A

Ukraine

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

Typical due diligence in Ukraine includes investigation of corporate, intellectual property, real estate, commercial, environmental and litigation issues. Recent enhancement of compliance regulation worldwide has forced potential business partners to put compliance issues to the top of the agenda. This attention is well warranted given that despite all the opportunities presented by an emerging economy, Ukraine belongs to a jurisdiction with a high corruption index.

To minimize the risk of compliance breaches resulting in significant fines, damage of reputation as well as clean-up costs and efforts, a buyer should place great emphasis on due diligence on the potential target's compliance with anti-bribery, money laundering and sanction laws before engaging in business activity in Ukraine.

Independent appraisal

Generally, independent appraisal is not required in a share deal or an asset deal. Usually, the price is adjusted after due diligence has been done.

Payment

Payments between Ukrainian companies must be made in local currency (hryvnia), while the foreign equivalent may be indicated. However, if a buyer and/or a seller is a non-Ukrainian entity, payments can be settled in foreign currencies. Nevertheless, if one of the parties is a Ukrainian entity, Ukrainian currency control restrictions may apply.

Signing/closing

Share sale

In the majority of cases, signing and closing are not simultaneous. Usually, closing takes place after all the conditions identified in the share purchase agreement have been fulfilled.

Asset sale

When a business is being transferred by way of an asset purchase, each individual asset needs to be transferred in accordance with the transfer formalities that apply to that type of asset. For example, an agreement for the transfer of real estate is subject to mandatory notarization, and the transfer of certain types of assets (e.g., vehicles) must be documented in a prescribed form.

In such cases, the transfer of title occurs after the registration with the relevant authorities.

Approvals/registrations

Foreign investment

Two categories of restrictions apply to foreign investment activity in Ukraine. The first relates to general restrictions on investment activity, which are applied to both foreign and domestic investors. Under applicable Ukrainian legislation, certain types of business activity may be pursued only by state-owned enterprises, such as the rocket industry, banknotes and certain blank forms of securities certificates. The second category relates to certain restrictions applicable only to foreign investors. For example, foreign citizens and legal entities are prohibited from owning farmland in Ukraine and are only authorized to own land designated for non-agricultural use.

Merger control

Generally speaking, Ukrainian competition legislation requires a filling to the Antimonopoly Committee of Ukraine ("**AMC**") and obtaining prior approval before closing of the transaction if the transaction qualifies as a concentration, and the financial thresholds described below are exceeded.

In Ukraine the following transactions are considered to be concentrations:

(i) mergers or consolidations of business entities;

(ii) acquisition of direct or indirect control over a business entity or part thereof, including through:

  (a) direct or indirect acquisition into ownership, lease, concession or management of a significant part of assets of a business entity (including in the process of liquidation);

  (b) appointment to the positions of chairperson and/or deputy chairperson of the supervisory/management board or other supervisory/executive body of persons, who already hold similar positions in other business entities; or creating a situation where more than half of the members of these bodies hold similar positions in other business entities;

(iii) establishment of a business entity by two or more business entities that will engage in independent business activities over a prolonged period, provided that such establishment does not result in the coordination of competitive conduct among the founding business entities, or among them and the newly established entity;

(iv) direct or indirect acquisition of, obtaining ownership of or management over the shares (participatory interests) of a business entity if such acquisition results in obtaining or exceeding 25% or 50% of the voting rights in the highest governing body of the target business entity.

The above-mentioned types of transactions are subject to prior AMC approval if:

(i) the aggregate worldwide asset value or turnover of all parties to the transaction exceeds EUR 30 million while the Ukrainian asset value or turnover of each of at least two parties to the transaction exceeds EUR 4 million for the fiscal year preceding the year of the transaction; or

(ii) the Ukrainian asset value or turnover of the target, or sellers of assets, or at least one of the founders of the new business entity exceeds EUR 8 million, while the worldwide asset value or turnover of the other party exceeds EUR 150 million for the fiscal year preceding the year of the transaction.

The financial thresholds are calculated on a group level. Therefore, all business entities/persons related by control to the transaction parties (including via their ultimate beneficial owners/parent companies, if any) should be taken into account when doing the calculations.

The filing obligation is mandatory, and even foreign-to-foreign transactions with no material nexus to Ukraine have to be cleared by the AMC if the above-mentioned financial thresholds are exceeded.

If the transaction documents contain any restrictive covenants (e.g. non-compete, non-solicitation arrangements), under Ukrainian competition legislation, such restrictive covenants may qualify as notifiable "concerted actions" and, thus, may require a separate AMC approval.

Other regulatory or government approvals

Usually, the acquisition of shares or assets of a Ukrainian company does not require other regulatory or governmental approvals. However, in some cases some industry-specific approvals may be required.

Employment

In a share purchase the position of the employees remains the same as all rights, duties and liabilities owed by, or to, the employees of the target company continue to be owed by, or to, the target company. The buyer inherits all those rights, duties and liabilities by virtue of being the new owner of the target company.

In an asset sale, the transfer of employees from the target company to the buyer is not within the discretion of the parties, but is subject to each employee's consent. On balance, the buyer is not obliged to employ all (or any) of the employees, unless it wishes to hire all (or some) of them.

Tax

Generally, Ukrainian legislation does not provide for any stamp duty or similar transfer taxes to be paid in connection with the sale or purchase of shares (or any other corporate rights) in a Ukrainian legal entity. However, if the parties choose to execute the agreement in notarized form (which is not mandatory), stamp duty of 1% from the value of the contract will apply. Value added tax (VAT) is generally not payable on the purchase of shares.

In an acquisition of assets, state duty may apply to notarized transactions on the sale of real property. The rate of the state duty may vary significantly, depending on the nature of the transaction. In addition, the sale of a company's assets will be subject to value added tax at a rate of 20%.

Additionally, the transfer of assets as part of a corporate reorganization (e.g., a merger) from a merging entity to a surviving entity is specifically exempted from VAT, provided that:

- the surviving entity acts as the legal successor of the entity transferring the assets; and
- both the merging and the surviving entity are registered for VAT purposes.

Effective from July 2020, Ukraine has introduced a mechanism to tax capital gains arising from the sale of real estate rich companies deriving their value from immovable property located in Ukraine. Capital gains from the alienation of shares/participatory interest in a foreign company which directly or indirectly owns a Ukrainian real estate rich company would be subject to taxation in Ukraine, if for any period during the last 365 days: (i) the foreign company's shares/participatory interest derive more than 50% of the value from the capital in the Ukrainian company; and (ii) more than 50% of the value of the Ukrainian company was generated by real estate located in Ukraine. Please refer to section Tax below for more detail.

Post-acquisition integration

There are various types of integration of a target into the buyer's corporate structure in Ukraine: merger, shares and asset acquisitions.

Ukrainian legislation allows two types of mergers. These are by absorption, where one of the merging entities survives and the other disappears, and by consolidation, where all the merging entities merge into one newly established entity. Some items of the disappearing company are non-transferable, such as, for example, most of the licenses, approvals (permissions and authorizations issued by governmental bodies or special organizations), and certificates of compliance. It is important to bear in mind that both extra time and finance could be required for all these procedures.

However, merger techniques are not currently widely used in Ukraine for the purpose of the acquisition of companies and businesses. Instead, acquisitions of businesses and companies are usually carried out through the acquisition of the shares of a joint stock company or through the purchase and assumption of the participatory interests of a limited liability company.

With regard to asset acquisitions, because they are technically burdensome, time-consuming and involve the imposition of VAT, they are rarely used in Ukraine.

Common deal structures

What are the key private M&A deal structures?

Acquisitions of businesses and companies are usually carried out through the acquisition of the shares of a joint stock company ("**JSC**") or through the purchase of participatory interests of a limited liability company ("**LLC**"). Very often large transactions in relation to privately owned businesses are done at the level of holding vehicles outside of Ukraine to ensure clear-cut application of English law and smooth transfer of title to the shares. Asset acquisitions are rare as they are technically burdensome, time-consuming and are subject to VAT.

Ukrainian law provides for two types of mergers. These are either by absorption, where one of the merging entities survives and the other disappears, or by consolidation, where all merging entities merge into one newly established entity. Except for internal corporate restructuring, merger techniques are rarely used in Ukraine for the purpose of acquisition of companies and businesses.

Merger by absorption: under the Ukrainian legislation, a merger by means of absorption entails legal reorganization of the merging entity. Such merger leads to dissolution of the merging company as a legal entity, while the company into which the merging company transfers its assets and liabilities continues to exist as the legal successor to the merging company. The merger is deemed complete from the moment of the execution by the merging company of a 'transfer balance act,' effecting the transfer of its assets and liabilities to the surviving company, and upon the removal of the merging company from the state register.

Merger by consolidation: consolidation is effected through the formation of a new legal entity, either a JSC or an LLC, and through two or more merging entities transferring all of their assets and liabilities to the newly formed entity in exchange of ownership rights in the new entity. As a general rule, the allocation of shares (participatory interest) in the new company shall be proportionate to the number (amount) of shares (participatory interests) held by the shareholders (participants) of the merging entities and taking into account the ratio between the amounts of the registered capitals of the merging entities and the amount of the registered capital of the new company.

M&A deals in relation to state-owned assets are made through a privatization process, which underwent significant changes in 2018. The privatization process is carried out by the State Property Fund ("**SPF**") and its regional branches. The process varies depending on whether an asset qualifies as a 'large privatization asset' or a 'small privatization asset.' The default scenario for large privatization assets is an open-bid auction sale, the type of which should be determined by the SPF. The main features of the acquisition of a mid- to large size state-owned enterprise may be summarized as follows:

- a potential buyer of a state-owned enterprise must meet certain statutory criteria, including domiciliation criteria;
- due diligence in respect of a state-owned enterprise put up for sale is usually very limited in time;
- the SPF is not receptive to heavy negotiations of the relevant transactional documentation and tends to use a standard Ukraine-specific acquisition agreement;
- at the buyer's request, the privatization rules allow the privatization agreement to be governed by the laws of England and Wales to the extent that the relevant elements of the agreement are not subject to mandatory provisions of Ukrainian law. This option is only available until 2021; and

- an acquisition agreement usually contains investment obligations of the buyer; such obligations maynot necessarily require direct cash investments, but almost always obliges the buyer to maintain certain production and employment levels of the state-owned target.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

The most common vehicle for conducting business activities in Ukraine is an LLC. Private and public JSCs are also very widespread and are the targets for private M&A transactions. All of these companies embody the concept of limited liability for investors.

What are the different types of limited liability companies?

The legal nature of an LLC is similar to that of a German GmbH or a French SARL, while JSCs are, in broad terms, closer to German AGs or French SAs, respectively. Investors in LLCs and JSCs—i.e., its participants or shareholders—are liable for the company's commitments only to the extent of their contributions to its registered capital (reflected as a share or a participatory interest). In 2018, the legislation on LLCs in Ukraine was significantly improved by the adoption of the special law regulating the operation of these companies and significantly widening the freedom to define the operation of LLCs by their owners.

Currently, no minimum capitalization is required to establish an LLC, however, it is implied that it should be of a positive value. The share capital of JSCs shall not be less than approximately UAH 5,900,000 (equivalent of approximately EUR 195,000). There are two ways to increase the registered capital of an LLC or a JSC, namely: (1) using its undistributed profit, or (2) by means of additional contributions of participants (shareholders) into the capital. Unlike LLCs, JSCs may issue shares of various classes, such as ordinary and preferred shares.

The default rule for both LLCs and JSCs is that each participant (shareholder) has a number of votes proportionate to the percentage of its shares (participatory interest) held by such shareholder (participant). In contrast to a JSC, an LLC's articles may provide for a differing way of allocation of votes.

There are no quorum requirements for LLC's meetings of participants. The key decisions of LLC requiring unanimous vote from all the participants should be made as to determination of procedure for entry into related party transactions, valuation of in-kind contributions into the capital of LLC, establishment of the requirement to procure consent of other participants for pledge over participatory interests, as well as determination of procedures for implementation of the participants' pre-emptive rights and increase of registered capital by means of additional contributions different from those stipulated in the law. The key instances when the three-quarters of the total number of votes is required include amendments to the articles of association of the LLC (save for the cases where a higher threshold is established by law), as well as changes of the amount of the registered capital.

The quorum for the shareholders' meetings of JSCs is 50% of the total votes except where a higher threshold applies. The three-quarters of votes of the shareholders registered for the shareholders' meeting is required, for example, in cases of amendments to the articles, issuance of additional shares, changes to the share capital, non-application of the mandatory buy-out procedures for private JSCs as a result of acquisition of more than 50% of their shares. The articles of a private JSC may allow for the shareholders' meeting to decide upon the matters falling within the competence of the supervisory board only if such a decision is supported by 95% of all the shareholders of the company.

The participant of an LLC shall have a pre-emptive right to acquire the participatory interest of the selling participant, unless otherwise established by articles or a participants' agreement (corporate agreement) to which the remaining participant is a party. As to the JSCs, only the shareholders of private JSCs may have the pre-emptive rights, provided that the articles vest them and provided further that the number of the shareholders at the time of approval of the articles providing for the pre-emptive right does not exceed 100.

Prior to 2018, most public JSCs operated on the basis of essentially same corporate rules as private JSCs. Before 2018, public JSCs literally existed on paper in that it was enough for a public JSC to comply with a simple formality to register its shares with a local stock exchange. However, now to be able to have the status of a public JSC its shares should be publically offered or the JSC should ensure that its shares are listed and it complies with the minimum stock exchange listing requirements including, among other things, the freefloat, revenue and profit requirements.

Is there a restriction on shareholder numbers?

No, there are no restrictions on shareholder numbers.

What are the key features of a share sale and purchase?

By law, most of the share acquisition deals shall involve a licensed broker acting on behalf of one ofthe parties. The transfer of shares is done based on instructions of both parties submitted to the depository institution of the seller and the depository institution of the purchaser.

Unlike shares, acquisition of participatory interests in an LLC does not require involvement of a securities broker. However, the transfer of the participatory interest would be made based on the act of transfer and acceptance certified by a notary to be subsequently submitted for the purpose of registration of the transfer with the state register.

The transfer of title is subject to the mandatory Ukrainian law requirements; however, it is often seen in the M&A transactions in respect of shares in Ukrainian companies that the parties opt for the laws of England and Wales as governing law and agree to an arbitration forum located outside of Ukraine, save where there is no nexus to a foreign jurisdiction.

What are the key features of an asset sale and purchase?

An asset acquisition may be structured either as acquisition of the 'total gross assets' of the target, or as the acquisition of only a portion of the target's assets.

Acquisition of the 'total gross assets' of the target: a sale of target company's total gross assets is a sale of a business as a going concern, including all of its rights and obligations.

Acquisition of selected assets of the target: in this type of asset sale, the buyer is free to select the assets it is willing to acquire (including accounting receivables and the contractual rights of the target) save where the acquired assets are subject to any encumbrance, the buyer will only be liable for those obligations of the target company which it expressly assumes. Hence, a sale of assets is preferable in situations where the target has significant liabilities that the buyer does not wish to assume, provided such sale does not lead to bankruptcy of the company, in which case the participants (shareholders) of the company may be found liable.

Where the business is subject to licensing, an asset acquisition becomes less attractive, since all licenses and permits issued to the target are not automatically transferrable. In addition, the transfer of the target's rights to certain types of assets (e.g., an interest in land) is subject to a certain amount of discretion of the state authorities.

An important tax consideration here is the applicability of the VAT (20%) to the asset deal to be paid by the seller, which increases the transaction value.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

Yes, they are quite commonly prepared in addition to the negotiations of the transaction documents. In most cases, they are not binding on the parties except that it is very common for the parties to be bound by the exclusivity, confidentiality and dispute resolution provisions. It is quite common for the letters of intent or term sheets to be governed by English law because Ukrainian law essentially does not allow them to have a binding effect.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: Exclusivity provisions are fairly common.
- Break fee: Break fee arrangements are rarely seen in the existing buyer driven Ukrainian M&A market.
- Confidentiality: Binding confidentiality undertakings in term sheets are seen in almost every M&A transaction.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Although there is a tendency to include these binding arrangements into full-fledged standalone agreements, it is very common for the letters of intent or term sheets to directly deal with these issues differentiating between the provisions of binding and non-binding nature.

Is there a duty or obligation to negotiate in good faith?

We rarely see such provisions in the English law governed term sheets in the Ukrainian market. Ukrainian law does not provide for any effective protections in such case.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: very common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: cash free/debt free is very common. Working capital is fairly common. NAV is rarely seen. It also remains fairly common for parties to agree a fixed price (not subject to any adjustment).

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely; an upward adjustment limit is more common than a downward adjustment limit.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: a completion balance sheet is usually prepared by the buyer, which may vary depending on the stake being purchased (i.e., 100% or a minority stake).

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely.

Is an earn-out common?

Frequency/market practice: rarely; this depends on the type of business being bought and/or the transaction structure.

Is a deposit common?

Frequency/market practice: rarely; a deposit will sometimes be used.

Is an escrow common?

Frequency/market practice: fairly common.

Is a break fee common?

Frequency/market practice: a break fee is fairly common and particularly common in distressed transactions.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common, especially if market conditions deteriorate.

Is the MAE general or specific?

Frequency/market practice: this varies from deal to deal.

Is the MAE quantified?

Frequency/market practice: very common.

Covenants

Is a non-compete common?

Frequency/market practice: very common, though for a non-compete to be enforceable in Ukraine, a prior approval of the AMC (Antimonopoly Committee of Ukraine) is required.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: rarely; waterfall provisions are not normally used.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common, though there is a high risk that it will be unenforceable in Ukraine.

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common, though there is a high risk that it will be unenforceable in Ukraine.

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; some access is usually given to the buyer. Broad access or control in the form of veto rights over certain transactions can create competition law risks.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: fairly common; whenever there is repetition of warranties at closing, the seller will normally request a right to update the disclosures made at signing. Consequences vary and include the right to abort the deal.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: rarely; representations are not common. Warranties are often qualified by monetary thresholds of materiality. The use of qualifiers, e.g., 'key customer' or 'material IP,' is also common.

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge is usually qualified as actual knowledge acquired after due enquiries of senior managers. A list of specific people is also used.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: rarely; it depends on the bargaining position of the buyer as such warranty is strongly resisted by the seller. Generally, this is not common.

Is disclosure of the data room common?

Frequency/market practice: rarely; it depends on the bargaining position of the buyer as such warranty is strongly resisted by the seller. Generally, this is not common.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: rarely.

Is a bring-down certificate at closing common?

Frequency/market practice: rarely; bring-down certificates are rarely used.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate is common.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: the common cap amount is 100% for title and capacity warranties (and other fundamental warranties). The cap on liability under business warranties varies from deal to deal. The overall liability cap (for all claims) is often 100% of the purchase price or, on larger transactions, less.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: this varies from deal to deal. Often, the cap also applies to liability under indemnities.

What are the common exceptions to the cap?

Frequency/market practice: it is common to have different caps for, e.g., title and capacity warranties and for liability for other claims under the agreement.

Is a deductible or basket common?

Frequency/market practice: very common.

Is a *de minimis* common?

Frequency/market practice: very common.

How long does seller liability survive?

Frequency/market practice: three years is common.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: fraud is often exempt.

Is warranty insurance common?

Frequency/market practice: rarely.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: rarely.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: rarely.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: rarely.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: fairly common.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: fairly common; they are sometimes used in relation to actual knowledge.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes, save where there is no nexus to a foreign jurisdiction.

What is the common governing law?

Frequency/market practice: English law is used if the parties are resident outside of Ukraine (which is often the case).

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is more common, usually in the LCIA or the Arbitration Institute of the Stockholm Chamber of Commerce.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: stamp duty is not payable in Ukraine.

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: very common.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

United Kingdom

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

While the types of documents for which review is required (and consequent issues that arise) will be determined by the particularities of the transaction and target company or business, some common due diligence issues with a distinctly UK dimension include the following[1]:

- Pensions: Defined benefit or final salary pension plans, which require the employer to fund retirement benefits up to a specified level (typically calculated on the basis of employees' salary and years of service), can place onerous and volatile funding obligations on the employer. Defined benefit plans are heavily regulated and the UK pensions regulator has significant "anti-avoidance" powers that it can impose on employers, who directly participate in the defined benefit plan, and more widely on group companies, in circumstances where there has been an event that is materially detrimental to the ability of the pension plan to meet its liabilities. The extent of pension risk passing to a buyer will vary depending on the structure of the particular transaction (share or asset sale) and the nature of the particular arrangement.
- Environment: Liability for contamination does not rest solely on "Class A persons" or original polluters, but can be extended to "Class B persons" or current owners and occupiers of the contaminated property (such as buyers) if Class A persons cannot be found or identified. It is therefore important to carry out due diligence on leases to ensure that they do not contain any obligations on the occupiers relating to environmental liabilities.
- Compliance: A company doing business in the UK (whether or not through a UK-incorporated subsidiary) will be brought within the remit of the Bribery Act 2010 in respect of all of its UK and overseas operations. In addition, the UK has strict anti-money laundering requirements, put into force by the Money Laundering Regulations 2007 and applicable to a wide range of businesses (not just financial institutions). There is a general obligation on firms to establish and maintain appropriate and proportionate risk-based policies and procedures to prevent and detect potential money laundering activity. The Financial Services and Markets Act 2000 enhances the integrity of the UK financial markets by including the offense of market abuse and works in tandem with the criminal sanctions against insider dealing and market manipulation. Finally, the UK also imposes a system of financial and trade sanctions that prohibits dealing with the assets of, or making funds available to, certain individuals and entities. Some of these apply to specified countries, territories or governments, while others relate to individuals or organizations associated with terrorism.
- Tax: Companies must ensure they have "reasonable" procedures in place to prevent the facilitation of tax evasion by a person associated with the company. If not, conviction under the corporate criminal offense of failure to prevent the facilitation of tax evasion could result in an unlimited fine for the company. Having such procedures in place should, however, provide a complete defence. Additionally, certain companies (multinational groups with a UK presence, other groups or companies with turnover exceeding GBP 200 million or balance sheet total of more than GBP 2 billion) must publish a UK tax

[1] The following issues are not the only ones to consider when entering into a private M&A transaction but are representative of the complexity of some of the issues commonly addressed.

strategy online setting out, for example, the approach to risk management and governance and tax planning in relation to UK taxation. Penalties apply for failure to comply.

Purchase price

The most common form of consideration is cash, though sellers may prefer to receive loan notes or equity from a tax planning perspective. It is common for the initial purchase price to be stated on a "debt-free cash-free" basis either on the basis of a "locked box" or with the inclusion of a purchase price adjustment mechanism in relation to working capital, for the purpose of confirming the value of the target company or business at closing. The completion balance sheet is usually prepared by the buyer (or an audit firm on its behalf) but is not formally audited. While it is not common to provide for deposits or break fees [2], an escrow arrangement is relatively standard in respect of warranty claims.

Approvals/registrations

Merger control

Mergers, acquisitions and the creation of certain joint ventures can trigger merger filing obligations to competition authorities around the world. In the UK, merger filings to the UK Competition & Markets Authority ("**CMA**") are voluntary. A filing may nonetheless be recommended if the transaction potentially raises substantive antitrust issues. The UK is also, until the end of the Brexit Transition Period (31 December 2020 at the time of writing), subject to the EU Merger Regulation ("**EUMR**"). The EUMR applies where the turnovers of the companies involved in a transaction exceed certain thresholds. If the EUMR thresholds are met, notification to the European Commission is mandatory and the UK merger control rules will not usually apply. Conversely, if the EUMR thresholds are not met, the EU rules will not usually apply.

Under the EU rules, the parties are not permitted to close the transaction until it is cleared by the European Commission. If the parties to a transaction are competing entities, it is important that they remain competitors until completion of the transaction and must take care not to exchange competitively sensitive information.

UK merger control legislation is contained in the Enterprise Act 2002 ("**EA02**") and enforced by the CMA. The EA02 applies to anticipated or completed transactions where:

- two or more "enterprises" cease to be distinct (i.e., are brought under common control or ownership); and
- either one or both of the following criteria are satisfied:
  - the UK turnover associated with the enterprise that is being acquired exceeds GBP 70 million (the turnover test); or
  - as a result of the merger, a share of 25% or more in the supply or consumption of goods or services of a particular description in the UK (or in a substantial part of the UK) is created or enhanced (the share of supply test).

The target company will be "brought under common control or ownership" in the following circumstances:

- when one party acquires a controlling interest in the other party (legal control);
- when one party acquires the ability to control the commercial policy of the other (de facto control);

[2] In light of COVID-19, reverse break fees are now expected to become more common.

- when one party acquires the ability to materially influence the commercial policy of the other (material influence); or
- where a party that already has material influence or de facto control acquires a higher level of control.

Foreign investment

The UK has no exchange controls or mandatory foreign investment approvals of general application. Various approvals or notifications may be required in the case of acquisitions in certain fields, such as the banking, utilities, media and insurance sectors. However, these requirements exist principally because of the nature of the business concerned rather than as mechanisms to control foreign investment. The UK government intends to introduce a new standalone foreign investment review regime for mergers that raise national security issues. The timing for this has not been confirmed but it seems likely to be before the end of 2021.

The UK government has reserve powers under the Industry Act 1975, which enable it to intervene when there is a change of control (i.e., affecting 30% or more) of an "important manufacturing undertaking" resulting in control vesting outside the UK, which is contrary to the interests of the UK. However, these powers have never been exercised.

Additionally, under the UK merger control regime, reduced filing thresholds apply for specific categories of mergers that could raise national security issues. For UK mergers involving a "Relevant Enterprise" active in (i) the development or production of items for military or military and civilian use ("military and dual use"), (ii) quantum technology , (iii) multipurpose computing hardware, (iv) artificial intelligence, (v) cryptographic authentication technology; and (vi) advanced materials:

- the turnover test is met if the Relevant Enterprise's annual UK turnover exceeds GBP 1 million; and
- the share of supply test is met if, before it ceased to be a distinct enterprise, at least 25% of all the goods or services by virtue of which the enterprise being taken over was a Relevant Enterprise were supplied to or by the persons carrying on the Relevant Enterprise in the UK. In other words, the test is met, even if share of supply does not increase as a result of the merger.

Employment

Acquisition of shares

An acquisition of shares is not considered a transfer of an undertaking for employment law purposes. It will therefore not involve the transfer of employees, but simply a change in the ownership of the employer (not a change in the employer per se). As such, all rights, duties and liabilities owed by, or to, the employees of the target company continue to be owed by, or to, the target company and the buyer therefore inherits all those rights, duties and liabilities by virtue of being the new owner of the target company.

However, if there is a post-acquisition integration of the target company's business with the buyer's business, this is likely to constitute an acquisition of assets or a business transfer, and the considerations set out in the next section will be relevant.

Acquisition of assets

The automatic transfer of employees on an asset sale takes effect pursuant to the Transfer of Undertakings (Protection of Employment) Regulations 2006 ("**TUPE**"), provided that the asset sale comprises the sale of an undertaking, for example, a sale of a business (or an identifiable part of a business).

Where there is a relevant transfer, the contracts of employment of those employees who are assigned to the business being transferred transfer automatically to the transferee on their existing terms and conditions of employment (with the exception of old age, invalidity and survivors' benefits under occupational pension schemes). The transferee effectively steps into the transferor's shoes with regard to the transferring employees such that all of the transferor's rights, powers, duties and liabilities under or in connection with the transferring employees' contracts pass to the transferee, and any acts or omissions of the transferor before the transfer are treated as having been done by the transferee.

Employees of the seller's business have the right to refuse to transfer to the buyer, but they are treated as having resigned without entitlement to severance compensation if they exercise this right and, consequently, will have no remedy against either the seller or the buyer. There are two exceptions to this rule:

- where employees resign in response to a repudiatory breach of contract by the employer; and
- where the transfer involves or would involve a substantial change in working conditions to the material detriment of the transferring employees.

In these circumstances, employees will be regarded as dismissed and may have claims for unfair dismissal. Assuming that employees do not exercise their right to object to the transfer, the buyer stands in the place of the seller as regards the employees' contracts of employment.

Tax

Acquisition of shares

A buyer will generally be responsible for the stamp duty (a transfer tax) payable on the acquisition of shares, calculated at the rate of 0.5% of the stampable consideration (which will include amounts satisfied by the payment of cash or the allotment of marketable securities, together with the value of certain liabilities assumed or released). Relief is available (on making a claim) for transfers of shares between associated companies provided the necessary conditions are met. There are very few mitigation techniques available to reduce the stamp duty liability on a share acquisition, and these techniques generally require the full cooperation of the seller.

Acquisition of assets

While stamp duty is not payable on the acquisition of assets, stamp duty land tax ("**SDLT**") — a tax on land transactions — is payable on the acquisition of a chargeable interest in land. It is calculated at a sliding rate of up to 5% on commercial property and up to 15% of the chargeable consideration on residential property (which includes an additional 3% charge for "additional" residential properties where applicable, such as buy-to-let or second homes). Unlike stamp duty, any land transaction in England or Northern Ireland is liable to SDLT wherever and however the relevant transfer instrument is executed, regardless of the tax residence of the buyer of the land interest or whether the transaction is effected by an instrument. Different systems (with slightly different rates) apply in Scotland and Wales.

Value added tax (VAT)

VAT is generally not payable on the purchase of shares. VAT may be payable on the purchase of taxable assets (e.g., inventory and goodwill). However, to the extent that the transfer meets certain requirements in order to be categorized as a "transfer of a going concern," it will not constitute a taxable supply and no VAT will be payable.

COVID-19

What is the impact of COVID-19 on deal dynamics?

The global uncertainty caused by COVID-19 is expected to have wide ranging impact on the deal dynamics of private M&A transactions. In particular:

- the timelines for existing deals are expected to increase due to, amongst others:
  - business closures;
  - additional time required to complete enhanced due diligence; or
  - delays in obtaining shareholder approvals, notarisation, filings at Companies House and in preparing and collecting certain records; and
- previously agreed target valuations or payment terms may be re-negotiated due to macroeconomic factors such as market volatility, supply chain and demand disruption risks, travel restrictions and mandated business closures; and
- the balance of power in negotiation has shifted. What was a sellers' market pre-COVID-19 is now a buyers' market and, as a result, buyers are likely to try to shift more risk onto sellers.

The above will have a direct impact on transaction structures. We have highlighted in more details in our section entitled *Agreeing to the Acquisition Agreement*, the expected impact of COVID-19 on key transaction terms. Each of the specialist sections (*Tax*, *Foreign Investment Restrictions*, *Merger Control*, *Employment* and *Anti-Bribery Laws*) also provides a brief overview of the impact of COVID-19 on their area.

In terms of competitive auction processes, buyers relying on third party debt will be at a disadvantage compared to cash rich buyers. In addition, sellers may favor buyers who do not depend upon shareholder or require merger control approvals as this may reduce the uncertainty of a split signing and completion as well as the overall transaction timeframe.

What are key concerns from a DD perspective in light of COVID-19?

As a result of COVID-19, due diligence reports are likely to be reviewed with increased scrutiny and the following standard areas for diligence are likely to become the focus of renewed attention:

Due diligence area	COVID-19 DD lens
Counterparty	– The ability of a counterparty (whether buyer or seller) to stand behind obligations. – The need for credit support (e.g. bank / parent guarantee) where a counterparty is potentially weakened but not fatally so. – The risk of the transaction being set aside if a counterparty succumbs to insolvency (in which case the buyer may need to hand shares back and become an unsecured creditor of seller for purchase price).
Financial Performance	– Ascertaining the financial performance of target since last full accounts, – The need for robust current management accounts, information on debtor day / creditor day trends, changes in cost base, margins (low margin businesses may be at greater risk as a result of COVID-19), solvency.

	– Hard scrutiny of financial forecasts and "aged" forecasts will not be acceptable.
Supply chain	– Ensuring that the target's supply chain is robust will be key. – Identifying: ▪ any concentration on sole suppliers and on the continued capacity of suppliers to perform; and ▪ any incidences or anticipated contract breaches and / or evidence of pricing pressure (any discounts sought from suppliers). – Reviewing supplier contract terms for force majeure / change of control / termination rights.
Customer exposure	– Identifying: ▪ reliance of target on major customers and issues or concerns with target customers in general; and ▪ any incidences or anticipated contractual breaches, payment delays or pricing pressures. – Reviewing customer contract terms for force majeure / change of control / termination rights
Financing	Reviewing covenant terms and default events to check for: – any breach of existing finance documents (covenants; default events); and – any participation in government financial support schemes;
Operations	Is the business currently operating? If so, what changes to the business model have been caused by COVID-19?
Employees	Reviewing the health and safety policy, recent legislative developments affecting the area, and employee terms and conditions to check for: – sickness statistics; – whether employees are working on site or remotely; and – whether the furlough scheme has been applied properly.
IT Systems	Reviewing related warranties and cyber security / business continuity / disaster recovery policies to check the following: – operational stability of systems under current remote working circumstances; and – risk of cyber-attacks / data breaches due to remote working.
Litigation	Checking for any claims by or against the target (e.g., data breach, employment related, breach of contract and regulatory breach).
Insurance	Reviewing the scope and amount of coverage, excesses and exclusions, especially in relation to business interruption.

Compliance	Assessing the robustness of compliance policies and any deviations from policies during the pandemic to check for: – increased risk of instances of bribery and corruption (these often increase during recessions); – increased risk of anti-competitive behaviour (e.g., collusive practices emerging during lockdown); and – environmental compliance monitoring and reporting and whether this has been maintained.
Tax	Reviewing the extent of any deferred tax liabilities and associated resources for their discharge in the future.

Common deal structures

What are the key private M&A deal structures?

The acquisition of a target business in the UK can be effected by the purchase either of the shares of the company owning that business or of some or all of the assets comprising that business. The more commonly encountered route is the share purchase.

A share purchase involves the seller and the buyer (and any other parties, such as guarantors) entering into a share purchase agreement to record the agreement of the parties as to their respective rights, obligations and liabilities in connection with the sale of the shares in the target. On completion of the share purchase agreement, title to the shares is effected by the execution and delivery to the buyer of a stock transfer form ("**STF**"). Stamp duty at the rate of 0.5% of the consideration is payable on the STF (unless the consideration is less than £1,000). Once the STF has been stamped, the board of directors of the target company will approve the transfer and the statutory registers of the target (register of members, register of persons with significant control, etc.) will be updated to reflect the transfer of ownership of the target. It is only when the register of members has been updated that legal title to the shares transfers; the seller remains the legal owner of the shares until that time and the buyer is only the beneficial owner. The buyer invariably obtains protection in respect of its position by obtaining from the seller on completion of the share purchase agreement a power of attorney in respect of the exercise of the rights attaching to the shares.

A business purchase also involves the seller and the buyer (and any other parties, such as guarantors) entering into an asset (or business) purchase agreement to record the agreement of the parties as to their respective rights, obligations and liabilities in connection with the sale of the target business. That agreement must provide for the transfer of each type of asset in accordance with the formalities for a transfer of that type of asset. Subject to any requirements for the transfer and/or registration of a transfer of ownership of a particular asset (such as intellectual property), legal title to the assets transfers on completion of the asset purchase agreement.

Auction processes are frequently encountered in the UK for both share and asset sales.

Bid process letters are frequently encountered in the UK and typically are not legally binding.

A scheme of arrangement can also be proposed by the company in accordance with Part 26 Companies Act 2006. It is a court-sanctioned statutory process enabling a company to come to a binding arrangement or compromise with all of its members (or any class or classes of the members) or creditors (or any class or classes of the creditors) that may be used to effect the transfer of a target's shares or business. It is typically used only for publicly listed companies.

There is no simple UK statutory procedure that permits two UK companies to merge whereby one of them succeeds to all the assets and liabilities of the other and the latter is then automatically dissolved.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

A private company limited by shares.

What are the different types of limited liability companies?

A private company can be limited either by shares or by guarantee. In the case of a private company limited by shares, the shareholders' liability is limited to the amount unpaid (if any) on shares that they own, whereas in a private company limited by guarantee, the members will agree to contribute a certain amount to the company's assets on a winding-up and their liability will be limited to that amount. Because of the restricted recourse to shareholders in the case of a limited company, there is greater regulation of limited companies compared with unlimited companies (for example, rules relating to maintenance of capital).

Is there a restriction on shareholder numbers?

A private company limited by shares must always have at least one shareholder, but there is no upper limit on the number of shareholders.

What are the key features of a share sale and purchase?

All that is generally required to transfer legal title to the shares in a UK private company is for a stock transfer form to be executed by the seller, stamped with duty paid at the rate of 0.5% of the consideration and then registered in the register of members of the target. The share certificate in relation to the shares transferred will usually need to be delivered to the buyer at the same time (or if the share certificate has been lost or destroyed, an appropriate indemnity).

What are the key features of an asset sale and purchase?

When a business is being transferred by way of an asset purchase, each individual asset must be transferred in accordance with the formalities for a transfer of an asset of that nature. In respect of some assets, this will simply be a case of physically delivering the asset to the buyer but, in other cases, the formalities are more prescriptive, such as in the case of real property or intellectual property (where a separate instrument of transfer must be delivered and later registered).

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

Yes. A letter of intent is typically signed by the parties. It is usually not legally binding, save in respect of certain matters such as confidentiality, governing law and, perhaps, costs, etc.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: It is customary to include binding exclusivity provisions in the letter of intent or term sheet.
- Break fee: Pre-COVID-19, break fees were not commonly included in private M&A transactions, however reverse break fees are now expected to become more common.
- Confidentiality: It is customary to include binding confidentiality provisions in the letter of intent or term sheet.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Confidentiality agreements and exclusivity agreements are often negotiated as separate agreements in private M&A transactions.

Is there a duty or obligation to negotiate in good faith?

English contract law does not impose a general duty to negotiate in good faith. Subject to any agreement between the parties to the contrary (perhaps in a letter of intent), there is usually no recourse or liability to pay damages if a purchase agreement is not signed. On the other hand, failure to complete a purchase agreement that has been signed will usually result in liability for the party in default to pay wasted costs, etc. and, depending on the provisions of the purchase agreement, perhaps also damages for loss of bargain.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: very common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: the normal mechanism is 'cash-free/debt-free (using completion accounts) with a normal level of working capital'. Locked box adjustments were also common pre-COVID-19, but are expected to become less so and to be replaced by hybrid structures, where the price is still set by reference to a locked box account date, but with certain items (e.g. cash) tested at completion.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely pre-COVID-19 (apart from where public companies are involved), however it is anticipated that sellers will increasingly ask for floors or collars to avoid being unduly penalized by COVID-19.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually prepared by, or on behalf of, the buyer.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely; this is usually prepared by an audit firm (i.e., accountants) and checked by one too, but not formally 'audited.' (Audit implies a process that is not typically followed because these are special-purpose, rather than statutory, accounts).

Is an earn-out common?

Frequency/market practice: rarely; these were rarely used pre-COVID-19, but are expected to become more common. These are fairly common in the tech sector and in PE deals.

Is a deposit common?

Frequency/market practice: rarely pre-COVID-19, but anticipated to become more common.

Is an escrow common?

Frequency/market practice: fairly common.

Is a break fee common?

Frequency/market practice: rarely pre-COVID-19, but reverse break fees are expected to become more common.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: rarely; these were not very common pre-COVID-19, but are expected to become more common — whether expressed as a condition or as a right to terminate.

Is the MAE general or specific?

Frequency/market practice: both seen pre COVID-19. It is anticipated that it will become increasingly common to specifically exclude COVID-19, epidemics and pandemics from the definition of MAE, or to specify that, for these events to give rise to an MAE their impact on the applicable party must be disproportionate by comparison with others.

Is the MAE quantified?

Frequency/market practice: increasingly seen.

Covenants

Is a non-compete common?

Frequency/market practice: very common; but not from private equity sellers.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: rarely; waterfall provisions are uncommon.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: very common; usually in conjunction with non-compete. Private equity sellers will give a non-solicit of employees.

Are non-solicitation provisions (of customers) common?

Frequency/market practice: very common; usually in conjunction with a non-compete.

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common; the purchase agreement will typically contain in a schedule a lengthy list of restrictions on the ability of the seller to cause the target to act in a way that may adversely affect the value of the target. In light of COVID-19, it is expected that:

- on one hand, clauses enabling the seller to operate without the buyer's consent (where necessary to deal with the virus) will be increasingly asked for; and
- on the other hand, buyers will ask for specific covenants to maintain the financial condition of the target during the interim period (with increased focus on liquidity maintenance, debt self-monitoring and working capital) and financial reporting.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: very common; generally, there is broad access for private deals. There are competition law issues around potential 'gun-jumping.'

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: fairly common; updating schedules (or disclosure letter) is common but typically limited to matters that have arisen since signing of the purchase agreement. Notification of possible breach is common. In the case of a material breach, the right to terminate is common.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; materiality qualifiers are commonly seen but often not quantified (other than specific warranties, e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers depend on risk-sharing in the deal, and are often limited to actual knowledge and due enquiry of certain specified members of senior management.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: not at all.

Is disclosure of the data room common?

Frequency/market practice: very common.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common; repetition at completion was already common pre-COVID-19 and it is expected to become the norm.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: rarely.

Is a bring-down certificate at closing common?

Frequency/market practice: rarely; the use of 'bring-down' certificates is rare.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate in all material respects is common but often carve-out for fundamental representations (e.g., title and capacity) which must be absolutely true.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely; double materiality is usually avoided.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: commonly less than 100% in respect of business warranties. Mid-cap and larger deals see lower caps, e.g., 20%–50%.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: usually warranties only.

What are the common exceptions to the cap?

Frequency/market practice: fundamental warranties are often excepted (e.g., title, capitalization, authority). Often tax and specific areas of concern (such as anti-bribery and corruption) are excepted and specific higher caps can be negotiated for these.

Is a deductible or basket common?

Frequency/market practice: deductible is usually resisted and a tipping basket more common.

Is a de minimis common?

Frequency/market practice: very common.

How long does seller liability survive?

Frequency/market practice: general survival of 18–24 months is common.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: it is common to carve out fraud. Tax is commonly longer than general warranties.

Is warranty insurance common?

Frequency/market practice: warranty insurance is increasingly common, especially in private equity deals.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: fairly common for actually received insurance proceeds.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common for actually recovered from third parties.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: very common; this is required by law for warranty damages (not indemnities), and is usually incorporated into purchase agreements.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: provisions expressly addressing the impact of the buyer's knowledge as to liability are rare. However, when such provisions are included they usually provide for no liability of the seller if the buyer had knowledge.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: English law.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: litigation is more common.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: no, the buyer pays the stamp duty.

Is a separate tax covenant / indemnity or tax deed common?

Frequency/market practice: very common, almost universal.

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Guide to Navigating Global Private M&A

United States of America

Quick reference guide

Due diligence, pricing, and closing

Due diligence in the United States is generally fulsome and buyers of businesses in the United States can inherit litigation, anti-bribery, environmental, employment and compensation, labor union and other risks upon completion of an acquisition. Recently, privacy, anti-bribery, import/export, information security and related matters have risen in prominence as due diligence matters as a result of increased regulatory attention to compliance in the United States.

Pricing and payment

Wire transfer of funds is the typical method for payment in the US. Wire transfers through the SWIFT Code international system are also common.

The United States exercises few controls over foreign exchange transactions by US citizens or non-US persons. Generally, no approval from the US Department of Treasury or other finance authority is required to make an investment.

Signing/closing

Simultaneous signing and closing is common, particularly in straightforward transactions where no antitrust (or other regulatory) approval is required or where few (if any) third-party consents are necessary.

Approvals/registrations

Foreign acquisitions of US businesses are assisted by a general absence of exchange controls, government regulation, or licensing of foreign investment or foreign acquisitions in the United States. Below are the typical approval requirements.

Foreign investment (CFIUS)

The United States maintains an open investment policy subject to the President's authority to block or suspend transactions which he finds threaten national security. The President is assisted in reviewing transactions by the Committee on Foreign Investment in the United States ("**CFIUS**"), a multi-agency committee chaired by the Treasury Secretary.

CFIUS regulations require pre-closing filings for certain investments by any foreign person in US businesses developing critical technology, and by foreign state-affiliated investors in US critical technology, critical infrastructure, and sensitive personal data businesses. Parties in other transactions may make voluntary filings to CFIUS to secure clearance, thus insulating the transaction from after the fact questioning by the President or CFIUS. There is no time limit on CFIUS reviewing a transaction that has not previously been cleared and the President, assisted by CFIUS, can force a foreign investor to divest itself of an acquisition post-closing if he finds a risk to national security.

CFIUS has substantially expanded staff to identify un-notified transactions raising security concerns, and there has been a substantial increase in filings with CFIUS in recent years. Filing processes can take 30 days or more than 90 days, depending on the procedure and the attributes of the foreign investor and US business. Outcomes can be clearance, clearance with conditions, prohibition, or, in the case of a previously concluded transaction, divestiture.

Merger control

US antitrust law prohibits any acquisition or merger that would have the tendency to lessen competition or create a monopoly. Although a number of factors are considered when assessing the effect of a transaction on competition, market concentration is commonly the most important factor.

If a US acquisition meets certain minimum size levels, a Hart-Scott-Rodino pre-merger notification must be filed with the US Department of Justice and the Federal Trade Commission.

The filing thresholds are revised annually, with the next adjustment expected in the first quarter of 2021.

Unless an exemption applies, a notification generally must be filed when a transaction is valued in excess of USD 94 million, so long as one party has more than USD 188 million in either net annual sales or total assets and the other party has more than USD 18.8 million in total assets or annual net sales (if a manufacturer). Transactions valued above USD 376 million require notification irrespective of the size of the parties.

An acquisition or merger may trigger other regulatory or government approvals. The purchase and sale of securities, including the shares of a corporation and ownership interests in many other entities, are strictly regulated by both federal and state governments.

A non-US company may issue shares or other securities in the United States to finance an acquisition, for example, by exchanging its shares for the shares or assets of the target company. However, the shares or other securities must be issued pursuant to a registration statement filed with the Securities and Exchange Commission ("**SEC**") (containing or incorporating detailed information regarding the issuer's business affairs and financial condition), unless an exemption from registration is available. A commonly used exemption in acquisitions of closely held companies is the private offering exemption, that is, an offering to a limited number of sophisticated investors.

Employment

N/A

Tax

N/A

Post-acquisition integration

Overall, the United States M&A market is sophisticated and is accustomed to due diligence on matters such as bank signatory authority, IT integration, branding matters, post-closing tax planning, and other post-acquisition integration concerns that drive value.

Common deal structures

What are the key private M&A deal structures?

Key deal structures

A buyer can acquire a private company through a purchase of equity, a purchase of substantially all of its assets, or a state law merger or consolidation. The best method to use in any particular transaction depends on a number of factors, such as commercial considerations, tax considerations, third-party and corporate consents, and deal process and timing.

One method of acquiring a private company is through a purchase of equity. In an equity purchase, the buyer will purchase the target company's equity from the selling equityholders. Most commonly, the buyer will purchase the target company's equity with cash, but the buyer may also exchange a portion of its equity with the equity of the target company's equityholders to effectuate the acquisition.

A buyer can also acquire a private company through a purchase of assets. In an asset acquisition, the buyer will purchase all or a portion of the target company's assets and/or liabilities directly from the target company in exchange for cash or equity consideration. If all of the target company's assets are acquired, the target company is frequently liquidated simultaneously.

Equity consideration is less common than cash consideration in an equity or asset acquisition because it carries additional risks. Such risks include the possibility that the value of the buyer's equity may fluctuate between signing and closing, or that the equity may not be freely tradable.

All state laws provide for the merger of corporations and most states now provide for the merger of limited liability companies and other entities (including mergers of different forms of entity). In a merger, two entities are joined by operation of law, with all assets and liabilities becoming the property of the surviving entity (or a new entity) solely by filing a certificate of merger. Normally, one entity disappears and the other continues as the successor to both lines of business. The principal advantage of a merger is that it typically only requires a majority consent from the target company's equityholders for the buyer to obtain all of the target company's equity (although dissenting equityholders may have the right to obtain an appraisal of their equity and recover the appraised value in lieu of the amount offered to them in the merger). In a merger, the transfer of assets and the exchange of the target corporation's equity are automatic. No separate transfer documents are required. Additionally, valuable permits, contracts, etc. are easier to transfer in a mergerthan in an asset sale.

Auction processes

Auctions are typically used when multiple buyers are interested in the target company. The auction structure tends to favor the seller because it allows the seller to control the sale process. Sellers will ordinarily disclose information about the target in a favorable light and distribute a seller-favorable draft purchase agreement to potential buyers. Auctions also have the potential to generate a higher purchase price since the structure is designed to reach more buyers and maximize competition among them. However, there are also potential pitfalls for sellers. Auctions are costly and time-consuming, and carry an increased risk that potential buyers will leak transaction information or use the disclosure process to glean competitive information about the seller or target company.

Letters of intent

The parties to an acquisition transaction usually sign a letter of intent (sometimes also referred to as a memorandum of understanding or a term sheet) as a first step in the process. The letter of intent is usually non-binding and outlines the proposed key terms of agreement between the parties. It is used as a starting point for negotiating the definitive acquisition agreement of the transaction.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

In the United States, there are several types of entities used for business purposes, including corporations, limited liability companies and various forms of partnerships. The most common entities used for acquisition vehicles are corporations and limited liability companies.

What are the different types of limited liability companies?

The laws of all states in the United States provide for the organization of limited liability companies ("**LLCs**"). LLCs are becoming increasingly popular for privately held businesses in the United States. An LLC offers the flexibility to describe the entire relationship of the parties by contract, while still limiting the liability of each of the members to their investment in the company. The owners of an LLC are its members, who are analogous to a corporation's stockholders. No minimum or maximum applies to the number of members (i.e., one member is acceptable). The members typically enter into a limited liability company operating agreement (or LLC agreement), which governs the operation of the LLC, including the members' contractual rights, obligations and restrictions relating to their membership interests in the company. The members may generally select any management structure they desire. They may operate the company directly or may appoint officers or managers to conduct the daily affairs of the LLC. The ownership interests of the members in an LLC are known as membership interests or membership units. There are no limitations on the transferability of ownership interests under statute; however, members may provide for restrictions in the LLC agreement. For US tax purposes, an LLC with more than one owner can be treated as a partnership, or 'pass-through' entity, which generally avoids taxation at the entity level and passes the company's profits and losses through to the members. As such, an LLC can be very advantageous to a non-US acquirer.

Is there a restriction on shareholder numbers?

There is no restriction on shareholder numbers in an LLC.

What are the key features of a share sale and purchase?

The acquisition of shares or membership interests is generally simpler than asset acquisitions, especially if there are only a few equityholders and all are willing to sell. Where equity interests are acquired, all assets remain in the target company and few transfer documents are required. Retaining assets such as licenses, permits and franchises avoids the difficulties of obtaining consent from the issuing government agencies. Additionally, unlike in asset acquisitions, third-party consents for the assignment of important contracts and leases will generally not be required, unless they contain change of control clauses. In a share acquisition, the target company will usually retain its tax attributes, both favorable and unfavorable, assuming that the business of the company continues. There are, however, limitations on the future use of some attributes, such as net operating losses.[1] Additionally, the buyer retains the seller's tax basis in the target company's assets, even if the buyer paid a higher purchase price for the business, unless the seller consents to certain elections, which often become commercially negotiated deal points.

What are the key features of an asset sale and purchase?

In an asset acquisition, the buyer or its subsidiary acquires specific assets and liabilities of the target company. This may comprise 'substantially all' of the target's assets or only a division or line of business. The seller retains those assets and liabilities not acquired by the buyer. An asset acquisition is more complex than a share acquisition because each asset must be transferred. Clear identification of the specific assets to be transferred and the specific liabilities to be assumed by the buyer (as well as the specific assets and liabilities retained by the seller) is critical in an asset acquisition. An asset acquisition will generally trigger 'anti-assignment' clauses in the target's key contracts, licenses and permits, necessitating third-party consents for the transfer of certain valuable assets of the seller. If assets are acquired, the buyer's tax basis in the assets may be increased to reflect the actual purchase price (i.e., the so-called "basis step-up"). However, favorable tax attributes of the target corporation will normally be lost in an asset acquisition.

[1] The Coronavirus, Aid, Relief, and Economic Security Act ("CARES" Act) made significant modifications to the utilization of net operating losses ("NOLs") by removing the 80% limitation on the usage of NOLs arising in 2018, 2019, and 2020 and allowing such losses to be carried back five years. This greatly increases the utility of NOLs, but the restrictions relating to acquisitions of loss corporations under Section 382 were not relaxed under the CARES Act.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

The parties may sign a letter of intent setting out the principal points upon which the parties have reached tentative agreement. This is typically signed by the parties following initial due diligence (but prior to completion of a more fulsome diligence review) and prior to negotiation of the definitive transaction agreement. The letter of intent is useful in identifying important issues between the parties early in the process, before they have invested substantial time and money. Its disadvantages are that it may delay the preparation and signing of a definitive contract. Except for certain matters, such as confidentiality, 'standstill' and the like, a letter of intent is typically not legally binding between the parties.

However, a US party will be reluctant to make important changes in the terms set out in the letter of intent absent a significant change in the target or in the circumstances of the transaction. A letter of intent may also provide a basis for legal liabilities if one of the parties fails to negotiate the definitive agreement in good faith. Furthermore, the letter of intent may address significant matters, such as limitations on the liability of the seller. Thus, a non-US buyer should carefully consider and review all material terms contained in the letter of intent with legal counsel before signing it.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: It is very common to include exclusivity provisions in a letter of intent.
- Break fee: It is not common to include break fees in a letter of intent.
- Confidentiality: Legally binding confidentiality provisions are one of the key terms in a letter of intent. They are often set forth in a separate confidentiality agreement and referenced in the term sheet.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

In the United States, it is common for the buyer and seller to enter into preliminary agreements before negotiating the acquisition agreement.

In a private deal, the letter of intent often contains a strict exclusivity provision, or "no-shop" covenant, that prohibits the seller from soliciting, encouraging or negotiating offers from third parties. A no-shop covenant will also encompass restraints on sharing non-public information with parties other than the buyer, and put an obligation on the seller to ensure that none of its agents engage in third-party negotiations. An exclusivity agreement will commonly span the period of 30-60 days after the parties sign the letter of intent, but the length of time may vary.

Break fee agreements are not commonly included in a letter of intent.

The potential buyer of a business and the target company and/or sellers generally enter into a confidentiality or non-disclosure agreement prior to the commencement of due diligence. This is usually the first agreement signed by the parties in a potential transaction. Confidentiality agreements are often unilateral, imposing confidentiality obligations on the buyer with respect to the information provided by, or on behalf of, the target. However, a buyer will generally seek to make such obligations mutual if the target is also going to perform due diligence on the buyer (e.g., in a stock-for-stock acquisition).

Is there a duty or obligation to negotiate in good faith?

In the US, a letter of intent is generally non-binding (except as set forth in specific provisions, such as those related to exclusivity and confidentiality) and, as such, does not provide a basis for liability in the event the parties do not ultimately sign a purchase agreement with respect to the non-binding provisions.

The implied duty of good faith is likewise very limited at the preliminary negotiation stage, and generally does not apply until the parties sign a purchase agreement. There is a limited duty of good faith and fair dealing that applies when the definitive purchase agreement is signed.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: fairly common; it is rare for a private acquisition to not include a purchase price adjustment; purchase price adjustments were included in approximately 95% of private target deals in 2018-19.[2]

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: cash free/debt free and working capital are the most common metrics on which purchase price adjustments are based. An adjustment based upon a target's net asset value is unusual. Inventory adjustments, limited working capital adjustments and locked boxes occur but are infrequent.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: the buyer usually prepares the closing balance sheet.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely; historical balance sheets for completed fiscal years are often audited. Interim balance sheets are typically unaudited.

Is an earn-out common?

Frequency/market practice: infrequently; earn-outs were included in only approximately 27% of private target deals in 2018-19.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: very common; in 2018-19, over 80% of private target acquisitions contained an escrow holdback.

Is a break fee common?

Frequency/market practice: rarely.

[2] Deal term percentages are according to the American Bar Association's Private Target Mergers & Acquisitions Deal Point Study for 2018 and Q1 2019.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: very common; in 2018-19, almost all (approximately 96%) private target acquisitions contained an MAE closing condition.

Is the MAE general or specific?

Frequency/market practice: the MAE definition is usually general and forward-looking, and generally includes specific carve-outs of events or circumstances from constituting an MAE. Following the COVID-19 outbreak, it is becoming common practice for sellers to include specific carve-outs with respect to pandemic events in the MAE definition.

Is the MAE quantified?

Frequency/market practice: rarely.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common. Non-competes are common; however, enforceability is a question of state law and varies from state-to-state.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: blue-pencilling provisions are commonly included in a severability clause in the agreement. Most states permit courts to modify non-competes. Some states allow modification only if the agreement contains a severability clause. A non-compete of a three- to five-year duration is typically enforceable in the M&A context.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common; a non-solicitation agreement is common in conjunction with a non-compete.

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common; a non-solicitation agreement is common in conjunction with a non-compete.

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common; extraordinary corporate law and operational matters are typically restricted, including major financial transactions.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; broad access is generally given to buyers, although the target may seek to limit access to specified members of the management team and may require access restrictions so as not to interfere with the seller's and target company's business.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: rarely/fairly common; the ability to update disclosure schedules is uncommon. Notification of possible breach is fairly common. In the case of a material breach, there is a right to terminate.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: very common; materiality qualifiers are commonly seen but are rarely quantified (other than specific warranties, e.g., contract value).

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are usually based on constructive knowledge (after due inquiry), although an actual knowledge standard is also used. Knowledge is commonly limited to a list of persons or group of persons specified in the transaction document.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: rarely; approximately 16% of private target deals in 2018-19 included a so-called '10b-5' rep.

Is disclosure of the data room common?

Frequency/market practice: rarely.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: repeating or "bringing-down" representations at closing is very common; approximately 65% of private target deals in 2018-19 required representations and warranties to be accurate at signing and closing.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: representations and warranties are almost never repeated at all times between signing and closing.

Is a bring-down certificate at closing common?

Frequency/market practice: bring-down certificates at closing are common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: both the accurate 'in all material respects' standard and the Material Adverse Effect standard are common; approximately 32% of deals in 2018-19 included an 'in all material respects' standard at closing and approximately 67% of deals in 2018-19 included a Material Adverse Effect standard at closing. There are often carve-outs for fundamental representations which must be true in all respects.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely; double materiality is usually avoided.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: a cap can range from 1%-100% of the purchase price. The average cap was 8.99% of transaction value for private deals in 2018-19; the average cap amount has declined due to the increased use of representations and warranties insurance because caps are higher in deals without representations and warranties insurance than in deals that include representations and warranties insurance (e.g. the average cap for private deals without representations and warranties insurance in 2018-19 was 11.99% of transaction value; it was 5.82% of transaction value for private deals in 2018-19 with representations and warranties insurance).

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: caps commonly apply to indemnification obligations in the whole agreement (although breach of seller's/target's covenants are often carved out of the cap). Other limitations on liabilities (e.g., baskets) commonly apply only to the representations and warranties. Specific representations and warranties (particularly fundamental representations and warranties) or other items in the agreement (such as special indemnities) may have different cap amounts.

What are the common exceptions to the cap?

Frequency/market practice: fraud is usually excluded from the cap (e.g., approximately 97% of private transactions in 2018-19 included a carve-out from the cap for fraud). Certain fundamental representations and warranties (e.g., authority, capitalization, title to assets/equity and due organization) are also commonly excluded. Often, tax and specific areas of concern are excluded or may have specific higher caps. Breaches of seller's/target's covenants are also often carved out of the cap.

Is a deductible or basket common?

Frequency/market practice: very common. Baskets in the US can be structured either as deductibles or tipping baskets. In a deal with a deductible, the indemnifying party is only liable for losses over a stated amount. If the parties agree to a tipping basket, the indemnifying party is liable for the total amount of losses once they exceed a specified threshold. Of private target deals in 2018-19, approximately 74% had deductible baskets, and approximately 23% had tipping baskets.

Is a de minimis common?

Frequency/market practice: very common.

How long does seller liability survive?

Frequency/market practice: a general survival of 12-24 months is common.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: it is common to carve out fraud. In addition, tax, employee benefits and environmental matters are commonly carved out and typically survive until the expiration of the applicable statute of limitations. Other representations and warranties often carved out include authority, no conflict, capitalization, due organization, title of assets/equity and brokers'/finders' fees.

Is warranty insurance common?

Frequency/market practice: fairly common; while representations and warranties insurance were previously used primarily in the private equity space, it has been increasingly and widely adopted among strategic buyers as well (e.g., in 2018-19, over 50% of private target deals used representations and warranties insurance (compared to 29% of deals in 2016-17)).

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: fairly common in stock acquisitions, but less so in other types of acquisitions.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: very common.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: fairly common.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: fairly common; although the buyer typically has a duty to mitigate damages under the laws of some states (e.g., New York and Delaware), there has been a slight upward trend in including such an express obligation in purchase agreements (approximately 60% of private target transactions in 2018-19 included an express duty that the buyer mitigate losses, compared with 57% of deals in 2016-17 and 40% of deals in 2014).

Is there an exclusion of consequential damages?

Frequency/market practice: while it is somewhat common to expressly exclude 'consequential damages' (26% of private target transactions in 2018-19 expressly excluded consequential damages), most agreements remain silent on the issue (65% of the agreements were silent on expressly excluding consequential damages), particularly if the transaction uses representations and warranties insurance.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: rarely; it is not common to include such so-called 'anti-sandbagging' provisions. Agreements are often silent on this point. However, claims under a representations and warranties policy for matters of which the buyer had prior knowledge are likely to be excluded from coverage.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: parties often choose the laws of Delaware or New York.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: litigation is more common.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: there is no stamp duty in the United States.

Is a separate tax covenant / indemnity or tax deed common?

Frequency/market practice: it is fairly common to have a specific tax covenant/indemnity included in the purchase agreement.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A

Venezuela

Quick reference guide

Due diligence, pricing and closing

Due diligence

There are no specific due diligence issues in Venezuela as each transaction is unique. However, labor and tax matters should always be reviewed in detail, as well as compliance and anticorruption matters.

Pricing and payment

No special pricing and payment considerations are applicable; parties are free to agree on the manner in which consideration is paid.

Foreign exchange control

Venezuela currently has certain exchange control regulations ("**Exchange Regulations**"), which in practice limit the ability of private parties to convert Venezuelan currency (VEB or *bolívares*) into any foreign currency. As a practical note to sellers, they should carry out all payments abroad and in foreign currency.

Under the Exchange Regulations, the Venezuelan Government has been empowered to establish the exclusive official and legal mechanisms to exchange VEB into foreign currency and vice versa, and the exchange rate applicable therefor.

In August 2018, the National Constituent Assembly ("**NCA**") enacted the Constituent Decree that Repealed the Exchange System and its Illicit Activities Law[1] (the "**Decree**"). The Decree repealed (i) the Exchange Law; (ii) Article 138 of the Central Bank Law, only with respect to the offenses of negotiation and trade of foreign currency in the country; and (iii) any other provisions conflicting with the Decree.

The Central Bank and the Ministry of the People's Power for Economy and Finance entered into Exchange Agreement No. 1, which became effective in September 2018[2] ("**Exchange Agreement**"). The Exchange Agreement seeks the regularization of a new exchange policy in the country and, among others, established the "*free convertibility of the currency*" throughout the national territory under the terms of such Agreement, and further indicates that the then existing restrictions on exchange operations are lifted. The Exchange Agreement, however, centralizes in the Central Bank the purchase and sale of foreign currency arising from the public sector and from the export activity of the private sector.

Continuing with this shift in foreign currency exchange policy, in May 2019 the Central Bank published a resolution, Resolution No. 19-05-01[3] (the "**Resolution**"), enabling financial institutions governed by the Banking Law, authorized to act as exchange operators, to negotiate purchase and sale of foreign currency operations through their exchange desks.

Except for a few limited cases, to date the Exchange Regulations do not prohibit or otherwise restrict individuals and legal entities from (i) maintaining foreign currency accounts with foreign banks and/or brokers; and/or (ii) disposing or using the foreign currency maintained in such accounts, provided that such

[1] Official Gazette No. 41,452 of 2 August 2018.

[2] Official Gazette No. 6,405 Ext. of 7 September 2018.

[3] Official Gazette No. 41,624 of 2 May 2019.

funds are not subject to mandatory sale to the Central Bank. In addition, the Exchange regulations allow individuals and legal entities to maintain funds in foreign currency in local accounts with licensed banks.

According to the Exchange Agreement, individuals and legal entities of the private sector must make operations of purchase and sale of foreign currency through authorized exchange operators, under the regulation and administration of the Central Bank.

The Resolution establishes that the Central Bank will publish the weighted average exchange rate of the exchange operations negotiated through the Exchange Desks daily. In addition, the Resolution expressly states that this exchange rate will be the referential exchange rate for the purchase and sale of foreign currencies described by Article 9 of the Exchange Agreement (**Resolution**, article 3)[4].

Based on the provisions of the Resolution and the Exchange Agreement, the market sets the exchange rate, which results from the exchange operations negotiated through the Exchange Desks[5].

Signing/closing considerations

A deposit is not required. It is common for the parties to meet and execute the corresponding documents. However, due to political instability, many deals close remotely (e.g., through the exchange of signature pages via email).

Additional considerations for asset sales

Most asset sales are deemed to be a bulk sale (*venta de fondo de comercio*) and are regulated by the Venezuelan Commercial Code. The seller is required to make certain publications in a newspaper in the case of a bulk sale, as well as register the corresponding asset purchase agreement with the Commercial Registry. Assets must be clearly defined and the purchase price should be allocated between those assets where VAT is applicable and assets where VAT is not applicable.

If the required publications described in the prior paragraph are not made, the buyer becomes jointly and severally liable for all the seller's liabilities. The responsibilities of the buyer, however, may be limited to those expressly assumed in the asset acquisition agreement, provided that the publications have been made. The buyer will be jointly and severally liable for the pending tax liabilities of the seller as of the date of the transaction. The buyer's joint liability will cease one year after the notification of the bulk sale to the relevant tax authorities. Regardless of the statutory publications, the buyer will be liable for any violations of environmental regulations by the seller that have not been sanctioned prior to the asset transaction.

Approvals/registrations

In general, no government approvals are required to proceed with an M&A transaction.

Foreign investment

Venezuela has foreign investment regulations that require any new investor, as defined by law, to register with the Ministry of the Popular Power for Foreign Trade and Foreign Investment. In the context of M&A transactions, the registration of the seller or buyer with the foreign investment authorities may be required

[4] Article 3, Resolution: "*The Central Bank of Venezuela, in accordance with the information that the exchange operators provide, will publish daily in its Website the weighted average exchange rate of the operations negotiated through the exchange desks of the exchange operators, which shall be the referential exchange rate that Article 9 of Exchange Agreement No. 1 of August 21, 2018, refers to.*"

[5] According to the Resolution, exchange operators must inform the CBV of the exchange operations negotiated through the Exchange Desks on a daily basis (including the traded volume), no later than 1:00 pm.

pursuant to the foreign investment law. The foreign investor's rights do not take legal effect until the ministry has granted this registration. Such rights include the right to remit dividends and repatriate capital, pursuant to the applicable laws and regulations on foreign exchange control. To register the investment, the foreign investor must submit evidence of the entry of foreign currency, physical goods or technological contributions in the form of a contribution to the capital stock of the company. Once the investment is registered, the investor must update the registration and provide notice of any amendments regarding the investment.

The creation of a Venezuelan entity is not required to close an M&A transaction. However, keep in mind that setting up a Venezuelan company can be a burdensome task. The new entity must be registered with the Commercial Registry and certain permits and registrations must be obtained.

It may take six months to one year to incorporate and have a fully functional company.

Merger control

No prior notice to the Antimonopoly Superintendence is required. However, the Antimonopoly Superintendence has the power to review an M&A transaction post facto. The Antitrust Law prohibits economic concentrations that restrain trade or result in a dominant market position, and the Antimonopoly Superintendence is empowered to enjoin a prohibited economic concentration and to order its subsequent divestiture and apply substantial penalties.

Other regulatory or government approvals

No special requirements are provided in Venezuelan law to undertake an M&A transaction. However, depending on the specific business of the parties, it is possible that certain issues will have to be reviewed in detail, particularly for banks and insurance entities.

Employment

Share sales: In the event of a share purchase, the relationship between the entity and its employees is not affected.

Asset sales: In the event of an asset purchase, the buyer becomes the substitute employer of the employees transferred as a result of the transaction. The buyer in this case becomes liable for any vested indemnities related to the termination of employees. An employee may resign following an asset sale and would be entitled to receive the indemnities as if the employment relationship had terminated for reasons not attributable to the employee. The seller will be jointly and severally liable with the substitute employer (the buyer) for all the labor rights that transferred employees have accrued for a term of up to five years as of the date of the change of the employer (or as of the date the respective judgment becomes final in the event of judicial claims). Thereafter, only the substitute employer (the buyer) continues to be liable. In addition, notice of an asset transfer must be provided to the affected employees, the relevant Labor Inspector's Office(s), and union(s).

Tax

For asset sales, the applicable tax will depend on whether the transaction is deemed to be a bulk sale. Asset acquisitions are generally unpopular in Venezuela because transactional taxes may be incurred in addition to capital gains taxes, value-added tax, stamp tax payments and withholding taxes. The relevant asset purchase agreement must also be registered with the Commercial Registry.

Generally, sellers prefer to structure a transaction as a share purchase to provide more latitude for tax minimization. From the buyer's perspective, a share purchase may be attractive if the target company has significant tax losses to carry forwards. Such losses continue to be available to offset the income of the target company after the acquisition. The absence of a value-added tax in the case of a share transaction may also be regarded as an advantage by the buyer. However, the buyer will typically find an asset transaction more advantageous. In structuring a transaction, special care must be taken to avoid gift tax implications.

Due to high levels of inflation, historical cost is significantly lower than market value and an asset purchase at market value may therefore result in significant future tax savings based on inflationary adjustments for tax purposes in the case of ordinary taxpayers engaged in activities other than banking and finance. For fiscal years commencing after 31 December 2015, special taxpayers are excluded from the adjustment for inflation system for tax purposes. Banking and financial institutions were excluded from the adjustment for inflation system in 2014.

Post-acquisition integration

Given the current political instability in Venezuela, it will likely be a challenge to integrate two or more businesses, particularly given the highly regulated environment.

In particular, keep in mind the following post-acquisition integration considerations:

- the buyer assumes all rights and liabilities of the seller;
- in the absence of statutory publications under the bulk sales regulations described above, the buyer becomes jointly and severally liable for all the seller's liabilities;
- the Tax Administration must be notified of mergers; and
- the buyer will be liable for any violations of environmental regulations by the seller that have not been sanctioned prior to the asset transaction.

Common deal structures

What are the key private M&A deal structures?

The key deal structures used for private M&A transactions are asset purchases and share purchases.

Asset purchases

The buyer will typically consider an asset transaction to be more advantageous. This is because the buyer may obtain a stepped-up tax cost basis for depreciable or amortizable assets, including goodwill, equal to the purchase price and through the proper use of bulk sales rules, as well as avoid exposure to certain liabilities not otherwise expressly assumed in the purchase agreement.

To the extent that the asset transaction has been taxed, there is no tax on dividends distributed by the seller. This means that the shareholders of the seller will not have an additional tax burden when ultimately receiving the proceeds of an asset transaction. In the case of an asset transaction, however, the selling company's tax loss carry-forwards are not available to the buyer.

The sale of assets must be in writing and if the sale involves real estate, it must be incorporated into a public deed, which must be registered before the real estate registry. If the sale does not involve real estate, it may be carried out by a public deed or private document. Certain assets may be subject to value-added tax.

Share purchases

A share purchase usually provides more latitude for tax minimization. From the buyer's perspective, a share purchase may be attractive if the target company has significant tax loss carry-forwards. Such losses continue to be available to offset the income of the target company after the acquisition. The absence of a value-added tax in the case of a share transaction may also be regarded as an advantage by the buyer.

There is no legal requirement for an agreement for the sale of the legal and beneficial title to shares to be made in writing. No cumbersome formalities need be observed in connection with the purchase of shares, except for the execution of simple corporate documentation. Nevertheless, market practice in the majority of cases is for a share transfer to be documented between the seller and the buyer through a written share purchase agreement.

For private M&A deals in Venezuela, auction processes are not often seen.

Bid process letters are not used for private M&A deals in Venezuela.

Scheme of arrangement procedures are not applicable under Venezuelan law.

The only mergers available in Venezuela are statutory mergers, but those are rarely used, due to the inadequacy and ambiguity of the statutory rules. In a merger, the surviving company assumes all assets, obligations and liabilities of the absorbed company or companies.

In brief, share acquisitions and asset acquisitions are the most common types of transactions in Venezuela, mostly because statutory mergers, though provided for by the Venezuelan Commercial Code have, in practice, been used rarely, if at all. Besides the parties' specific commercial considerations, the choice between a share transaction and an asset transaction is influenced mainly by tax considerations and the need, if any, to avoid assuming hidden liabilities by operation of law.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

A corporation is the legal entity preferred by investors. The main types of corporate entities include:

- stock corporations (*Sociedad Anónima*);
- limited liability companies (*Sociedad de Responsabilidad Limitada*);
- general partnerships (*Sociedad en Nombre Colectivo*);
- simple limited partnerships (*Sociedad en Comandita Simple*); and
- stock limited partnerships (*Sociedad en Comandita por Acciones*).

Another way to carry out business in Venezuela is via a branch of a foreign company, which is deemed a commercial establishment of the foreign entity in Venezuela.

What are the different types of limited liability companies?

The capital of a limited liability company is divided into participation-denominated quotas. Under no circumstances may the quotas be represented by shares or marketable securities.

The formalities for incorporating a limited liability company are similar to a stock corporation. Any name available in the Commercial Registry may be used, and the words *Sociedad de Responsabilidad Limitada* or the corresponding initials "S.R.L." must be added. As with stock corporations, according to the current practice of the Commercial Registry Office, the name cannot include words in English or the word "Venezuela."

The capital of a limited liability company cannot be less than VEB 0,0002 nor more than VEB 0,02, and must be subscribed in full. At least 50% thereof must be paid in if the payment is in cash, and 100% if in kind.

The capital is divided into quotas which are fractions of equal amounts of not less than VEB 0,00001. The transfer of quotas may be subject to specific restrictions, which can make this type of entity useful for US income tax planning purposes.

Quotaholders are jointly and severally liable for a term of five years for the veracity of the value assigned to contributions in kind in the Articles of Incorporation. Each quotaholder has one vote for each quota owned. The profits of the company are distributed to the quotaholders at the end of the financial year, pursuant to a resolution adopted by the quotaholders' meeting or the directors.

Rules applicable to the company's management (administrators) are the same for both stock companies and limited liability companies. The administrators are jointly and severally liable both to the company and to third parties for violations of the law and the Articles of Incorporation, as well as for any other infringement while in office.

Is there a restriction on shareholder numbers?

Stock corporations and limited liability companies require at least two shareholders/quotaholders, respectively, to be properly constituted. However, once the entity has been constituted, the shares/quotas can be transferred to a sole shareholder/quotaholder. There is no limit on the number of shareholders/quotaholders.

What are the key features of a share sale and purchase?

The seller normally prefers a share purchase since it usually provides more latitude for tax minimization. From the buyer's perspective, a share purchase may be attractive if the target company has significant tax loss carry-forwards. Such losses continue to be available to offset the income of the target company after the acquisition.

The absence of a value-added tax in the case of a share transaction may also be regarded as an advantage by the buyer.

The regulations concerning public offerings for the acquisition of shares define "significant equity participation" as the number of shares representing 10% or more of the listed company's stock. These regulations cover tender offers made in cash or kind in the context of both hostile and non-hostile takeovers.

What are the key features of an asset sale and purchase?

The buyer will typically consider an asset transaction to be more advantageous. This is because the buyer may obtain a stepped-up tax cost basis for depreciable or amortizable assets, including goodwill, equal to the purchase price and through the proper use of bulk sales rules, as well as avoiding exposure to certain liabilities not otherwise expressly assumed in the purchase agreement.

To the extent that the asset transaction has been taxed, there is no tax on dividends distributed by the seller. This means that the shareholders of the seller will not have an additional tax burden when ultimately receiving the proceeds of an asset transaction. In the case of an asset transaction, however, the selling company's tax loss carry-forwards are not available to the buyer.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

Parties in a negotiation typically use a letter of intent. Although in many cases buyers may proceed in negotiations with sellers using such letters of intent (stipulating only a few provisions that are intended to be legally binding like confidentiality and exclusivity), under Venezuelan law, these pre-contractual letters will not necessarily have a legal effect because whether or not a letter will create legal obligations depends on the substance of what is said and not its format. In the pre-contractual phase, the parties must act in good faith.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: Exclusivity provisions are commonly used in letters of intent.
- Break fee: Break fees are not commonly used in letters of intent.
- Confidentiality: Confidentiality provisions are commonly used in letters on intent.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Exclusivity, break fee and confidentiality provisions are rarely supplemented with separately negotiated agreements (only in a few cases involving share purchase agreements).

Is there a duty or obligation to negotiate in good faith?

In the pre-contractual phase, the parties must act in good faith.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: rarely.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: cash free/debt free and working capital are fairly common, but NAV is rarely seen.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: this is usually prepared by the target company.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely.

Is an earn-out common?

Frequency/market practice: very common.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: fairly common.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common.

Is the MAE general or specific?

Frequency/market practice: both are seen.

Is the MAE quantified?

Frequency/market practice: fairly common.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: waterfall/blue pencil provisions are rarely used.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common.

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common.

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: rarely.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: fairly common; the consequence will vary depending on each negotiation.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: materiality is generally quantified by a specific amount.

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are increasingly common.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common.

Is disclosure of the data room common?

Frequency/market practice: fairly common.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: repetition at completion is fairly common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: repetition between signing and closing is fairly common.

Is a bring-down certificate at closing common?

Frequency/market practice: bring-down certificates are rarely used.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and correct.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: this will depend on each transaction.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: they are commonly applied to the entire agreement.

What are the common exceptions to the cap?

Frequency/market practice: key warranties are often excepted (e.g., title, capitalization, authority). Often, tax, labor and specific areas of concern are also excepted, sometimes with specific higher caps. Separate caps can be negotiated.

Is a deductible or basket common?

Frequency/market practice: both are common.

Is a de minimis common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: a general survival for 18-36 months is common.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: tax, labor and environmental liabilities are usually tied to the expiry of the statute of limitations time period.

Is warranty insurance common?

Frequency/market practice: rarely.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: rarely.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: rarely.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: rarely.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: rarely.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: rarely.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: yes.

What is the common governing law?

Frequency/market practice: the governing law will depend on each transaction.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: arbitration is more common and usually with the ICC.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: no, normally the buyer will pay for stamp duties.

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: fairly common.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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Guide to Navigating Global Private M&A Full version

Vietnam

Quick reference guide

Due diligence, pricing and closing

Typical due diligence issues

A potential investor may find it challenging to conduct a comprehensive due diligence exercise due to a lack of transparency among domestic enterprises. A target company may invoke State secrecy laws to prevent disclosure of information if the State has equity in the enterprise. In addition, potential investors may find domestic enterprises' record-keeping and accounting practices lacking compared with international standards, making the task of verifying a target company's compliance status even more challenging. Patience, diplomacy and good communication skills are necessary to obtain the relevant information pertaining to a target company.

Domestic enterprises in Vietnam are also typically unfamiliar with the documents required to be provided or disclosed in a due diligence exercise, or how to properly organize them for the other side. This may occasionally affect the results of a due diligence review, which may cause significant delays in obtaining information from the target.

The purchase price needs to be decided based on a fair valuation of the transferred assets/equity interests in order to avoid possible questions from relevant tax authorities.

Signing/closing considerations

Is a deposit required?

A deposit is not commonly required for share sale or asset sale transactions.

Is simultaneous signing/closing common?

Simultaneous signing and closing is not common in Vietnam due to the following reasons:

- Share/equity interest sale: Certain governmental approvals are required in order to effect the transfer and approval may be required before being entitled to contribute capital or acquire capital/shares ("**M&A Approval**"). The target company may also be required to update its Enterprise Registration Certificate ("**ERC**") or make certain notifications/receive confirmations to the authorities in order to reflect the buyer's name as one of its owners/shareholders.
- Asset sale: Certain common assets (e.g., real properties, vehicles) require registration and the transfer of those assets would not be effective and completed without satisfaction of those conditions.

It is possible for parties to agree on the simultaneous signing and closing, especially in transactions that are undertaken at the offshore level and subject to the laws of that jurisdiction.

Approvals/registrations

Foreign investment

Share/equity interest sale

Step 1

The M&A approval for the acquisition is required in two cases: (i) if the foreign investor is acquiring ownership in a target company engaged in a specified industry; or (ii) if the acquisition results in foreign investors or foreign-invested economic organizations owning 51%[1] or more of the charter capital of such target company.

The foreign investor and the target company must submit an application to the licensing authority to seek the M&A Approval. By law, the timeline for issuing the M&A Approval is within 15 days from the date of submission of the complete and valid application but it may take longer in practice.

Step 2

Upon completion of Step 1 or if Step 1 is not required, the target company is required to amend its ERC and/or conduct registration/notification of changes to its enterprise information.

The target company will submit an application to register the name of the buyer as the owner in its ERC (in a limited liability company), or to notify the changes of foreign shareholding in the target company (in a joint stock company). By law, within three working days from the date of submission of the complete and valid application, the licensing authority will issue an amended ERC or a confirmation letter acknowledging the change, as the case may be.

Under the Investment Law, the foreign investor acquiring shares/equity interest in an existing company is not required to update the Investment Registration Certificate ("**IRC**") of that target company. If the name of the seller is still recorded on the IRC as the investor of the target company, then the buyer may request for the IRC to be updated to fully eliminate all references to the seller.

The Investment Law does not itself provide for a cap on foreign participation in Vietnamese enterprises (listed or unlisted), but states that foreign investors can own unlimited charter capital in a corporate entity, subject to a cap on foreign shareholdings and market access restrictions.

The Investment Law lists 243 business sectors that are subject to conditions that may hinder foreign investors from carrying out the acquisition. For instance, according to Vietnam's WTO commitments, foreign investors and foreign invested enterprises are not allowed to distribute drugs and pharmaceuticals in Vietnam.

Asset sale

A foreign buyer cannot purchase assets directly from the Vietnamese seller and the buyer will need to set up a NewCo in Vietnam in order to acquire the target company's assets. For the purposes of setting up a NewCo in Vietnam, the foreign buyer needs to have an "investment project" in Vietnam for the NewCo.

The establishment procedures of the NewCo include two steps: (i) applying for an IRC and (ii) applying for an ERC. It normally takes one month to prepare the applications, and an additional two to three months to

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[1] This will be changed to 50% under the new Investment Law No. 61/2020/QH14, effective from 1 January 2021.

obtain the IRC and ERC. As a matter of practice, the licensing process may take longer depending on the nature of the project and the availability of the supporting documents.

Foreign exchange control

All transactions and payments within Vietnam must be effected in Vietnamese dong, except in certain cases as prescribed by the State Bank of Vietnam ("**SBV**").

In the event that:

- a foreign investor wishes to acquire shares or equity interest from a shareholder or member who resides in Vietnam, or contributes capital into, a target company operating in Vietnam that has:
    - an existing foreign member or shareholder and has already been required to obtain an investment certificate (or the IRC); or
    - 51% of its charter capital is held by foreign investors ("**FDI Company**"); or
- the acquisition of shares or equity interest (from the shareholder or member being a resident in Vietnam), or contribution of capital by the foreign investor results in the target company becoming an FDI Company,

the payment must be made through the direct investment capital account, which is opened in the name of the target company at a licensed bank in Vietnam, before reaching the seller's account.

If a foreign investor acquires from a shareholder or member being a resident in Vietnam shares or equity interest in, or contributes capital into, a target company operating in Vietnam, and such target company is not an FDI Company and will not become an FDI Company after such acquisition or contribution, the foreign buyer/investor itself will have to open an indirect investment capital account for the payment of the acquisition of shares or contributed capital to the seller.

Merger control (antitrust/competition approval)

Under the Competition Law, economic concentration can take the form of a merger, a consolidation, an acquisition or a joint venture.

If the enterprises participating in an economic concentration meet any of the following notification thresholds, such enterprises must notify and seek approval from the relevant competition authority:

- The total assets in the Vietnamese market of: (i) one of the enterprises participating in the Economic Concentration; or (ii) the group of affiliated companies of which one of the parties participating in the Economic Concentration is a member, reaches **VND 3,000 billion (approximately USD 129 million)** or more in the financial year preceding the economic concentration.
- The total sales or purchase revenue in the Vietnamese market of: (i) one of the enterprises participating in the Economic Concentration; or (ii) the group of affiliated companies of which one of the parties participating in the Economic Concentration is a member, reaches **VND 3,000 billion (approximately USD 129 million)** or more in the financial year preceding the economic concentration.
- The transaction value of the Economic Concentration is **VND 1,000 billion (approximately USD 43 million)** or more.
- The combined market share of the enterprises to the Economic Concentration is **20%** or more in the relevant market in the financial year preceding the economic concentration.

For economic concentrations involving credit institutions, securities companies and insurance companies, such transactions will be subject to separate threshold amounts.

Economic concentration shall be prohibited if it causes or potentially causes substantial anti-competitive effects on the Vietnamese market.

The preliminary assessment stage will take around 30 days. At the end of this preliminary period, the competition authority may grant approval for the participants to proceed with the economic concentration, or move the application into the official assessment stage. The competition authority shall carry out the official assessment of the proposed economic concentration within 90 days from the date of notification, with a possibility to request an extension of 60 days for more complicated cases.

Other regulatory or government approvals

A target company operating in special sectors may trigger special approvals from the industry management authorities.

Employment

Share/equity interest sale

Where an investor sells its equity in an enterprise and there is no change in the identity of the employer, it may be said that no legal transfer takes place merely by virtue of a change in the ownership of the employer and no consents are required.

Asset sale

The acquisition of assets does not automatically transfer the employees. The method for employee transfer in Vietnam is "termination and re-hire."

The law does not require the transferor to obtain the consent of a local labor authority, the employees or the trade union before the sale of an enterprise, nor does it require the transferor to give prior notice to the labor authority. However, if a layoff is to be conducted before or after the transaction, the employer must comply with the requirement for consultation with the employee representative and notification to the labor authority.

Tax

Share/equity interest sale

The transfer of capital interest and securities is not subject to value-added tax ("**VAT**"). In addition, no other transfer tax is imposed on an acquisition of capital or securities.

However, sellers will be subject to capital gains tax, at rates that differ depending on whether the sellers are individuals or corporate entities, and whether it is an acquisition of securities or capital.

In particular, individual sellers who are Vietnam tax residents pay personal income tax ("**PIT**") at a rate of 20% on the gains derived from the transfer of capital in an LLC. Non-resident individual sellers pay PIT at 0.1% on the transfer proceeds. For the sale of shares in a JSC, whether public or non-public, individual sellers will be subject to 0.1% PIT on the sale proceeds.

Vietnamese corporate sellers are subject to 20% corporate income tax ("**CIT**") on any gains derived from transfer of capital or shares. Foreign/offshore corporate sellers will pay CIT at a rate of 20% on any gains generated from the transfer of capital of an LLC or from the transfer of shares in a non-public JSC, and they will pay CIT at a rate of 0.1% on the transfer proceeds for a transfer of shares in a public JSC.

Vietnamese tax authorities have recently challenged the imposition of capital gains tax on "indirect share transfers" by referring to Decree 12/2015/ND-CP. Accordingly, taxable incomes (or gains) derived in Vietnam by a foreign/offshore company (regardless of whether it has a permanent establishment in Vietnam and the location of the business) are any incomes (or gains) derived from certain M&A activities, including the transfer of contributed capital, investment projects, rights to contribute capital, or rights to participate in investment projects, etc.

However, Decree No. 12 and other relevant tax regulations do not specifically address how the taxable gain would be calculated and which party would be liable for tax declaration and payment. This gives rise to uncertainty in implementation.

Asset sale

Registration fee

It is mandatory to register the ownership or use right of certain types of property in Vietnam, such as houses and land, ships, boats, automobiles, motorcycles, hunting rifles, and sports guns. Registration fees, known in Vietnamese as " *lệ phí trước bạ*," are imposed on the buyers of certain property when they register the ownership of the property.

Registration fees imposed on change of the ownership or right to use land and housesare 0.5% of the property value. Different registration fee rates apply for other items. However, except for the case of motor vehicles with fewer than 10 seats, aircrafts, and yachts, registration fees for one asset do not exceed VND 500 million.

Value-added tax

The transfer of tangible assets is subject to VAT. The rate may vary depending on the assets, but generally the standard VAT rate is 10%.

Corporate income tax

Any income derived from asset sale is regarded as other income and subject to 20% CIT. The net book value of assets transferred (substantiated with supporting documents as required under regulations) is deductible cost base. CIT payables (if any) will be provisionally paid by the Company on a quarterly basis. At the financial year-end, the Seller will prepare the annual CIT finalization return, which includes income/loss from this asset sale.

Post-acquisition integration

Where the existing and target businesses operate in the same or complementary fields, the acquirer almost always wants to integrate the two businesses in order to save costs and develop synergies. It is important to plan for post-acquisition integration well in advance of closing.

The significance of post-acquisition integration depends on the purpose of the acquisition. For example, financial buyers will focus only on the profit generation of the target while strategic buyers will concentrate on the business value of the target for long-term investment purposes.

Common deal structures

What are the key private M&A deal structures?

The acquisition of an enterprise can take different forms: the purchase of shares; the purchase of charter capital; the acquisition of assets; or the restructuring of an enterprise (merger, consolidation, division and separation). Share acquisition is the most common structure in the Vietnamese market, given that certain types of assets (e.g., land use rights, assets attached to lands, workforce) may not be transferrable or can only be transferred upon satisfaction of certain regulatory approvals.

For the purpose of business combination, the Enterprise Law contemplates two types of reorganization: (i) merger and (ii) consolidation of enterprises. All of these forms of enterprise reorganization take effect upon the approval of the relevant licensing authorities. Depending on the specific form of the enterprise reorganization, various rights and obligations cease to exist and others are assumed by the parties involved in such process. In particular:

(i) Merger

Under the Enterprise Law, an enterprise merger is defined as a process whereby one or a number of enterprises transfers all of its assets, legal rights, liabilities and benefits for the purpose of merging with another enterprise.

After a merger is completed, the target enterprise will cease to exist and the surviving enterprise will assume the legal rights and interests of the target enterprise. Additionally, the surviving enterprise will be liable for unpaid debts, labor contracts, property obligations and other liabilities of the target enterprise.

(ii) Consolidation

An enterprise consolidation is a process whereby two or more enterprises combine all of their assets, legal rights, liabilities and benefits for the purpose of consolidating among themselves so as to become a new enterprise.

In terms of consolidation, the consolidating enterprises will be extinguished upon completion and the new consolidated enterprise will assume the legal rights and interests, and is liable for the unpaid debts, labor contracts and other liabilities of the consolidating enterprises.

Merger is more common than consolidation in practice, although the application depends on the business objectives intended for the restructuring.

Which entity is likely to be the target company (on a share sale) or the seller (on an asset sale)?

Under the Enterprise Law, companies in Vietnam are referred to as 'enterprises.' In Vietnam, the following types of enterprises are most commonly seen in practice:

- single member limited liability company ("**SMLLC**");
- multiple member limited liability company ("**MMLLC**"); and
- joint stock company ("**JSC**").

What are the different types of limited liability companies?

(i) Single member limited liability companies

An SMLLC is owned by one organization or individual member (company owner) who is liable for the debts and liabilities of the enterprise to the extent of the amount of the charter capital of the enterprise. An SMLLC has the same legal status as an MMLLC and a JSC, but the company owner has more autonomy concerning decisions made about the enterprise. The company owner may appoint either a representative to be president, or more than one representative to create a BOM (comprising three to seven persons), which will implement the company owner's rights and obligations on its behalf.

In addition, there is no statutory term of office for the president. However, the statutory term of office for BOM members cannot exceed five years.

Similar to an MMLLC, an SMLLC must have a director or general director appointed or hired by the president or the BOM, who is responsible for the day-to-day operation of the enterprise and is usually the legal representative of the enterprise, although the charter may provide otherwise. Since the Enterprise Law came into effect on 1 July 2015, an SMLLC is allowed to have several legal representatives, as long as one of them resides in Vietnam and must authorize another person if he/she needs to travel abroad. The Enterprise Law stipulates that the president or the chairperson of the BOM will be the default legal representative if the charter is silent on that point.

The company owner must appoint controller(s) in a number at its discretion, who bear responsibility for supervising the performance of the BOM (or the president) and the director (or general director), and carrying out other tasks assigned by the company owner. The controllers can have a term of office not exceeding five years.

A company owner must contribute capital in a full and timely manner. An SM LLC can decrease its charter capital in two cases:

- when the LLC returns part of its contributed charter capital to the LLC owner, as long as the LLC is continuously operating for more than two years from the date of enterprise registration and the LLC ensures that it is able to pay all debts and other liabilities after returning the capital to the company owner; or
- when the company owner fails to contribute the charter capital as committed.

An SM LLC may increase its charter capital by way of additional investment from the company owner or by obtaining capital contributions from other persons. In the event that part of the charter capital is contributed by or transferred to another organization or individual, the enterprise must register to convert into an MM LLC or a JSC within 10 days of the date of complete transfer.

The company owner shall contribute the registered charter capital within 90 days from the issuance of the enterprise registration certificate ("**ERC**"). If the company owner does not fully contribute the registered charter capital, the company owner must register for the decrease in charter capital within 30 days from the deadline of capital contribution and shall be liable for the financial obligations of the SM LLC to the extent of all assets owned by him/her/it for failing to contribute prior to the registration of the charter capital decrease.

(ii) Multiple member limited liability companies (MM LLC)

An MM LLC is an enterprise that has more than one but no more than 50 members, which may be organizations, individuals, or a combination of both. A member can transfer, dispose of or ask the enterprise to buy back its capital contribution portion in accordance with the Enterprise Law or as stipulated in the enterprise charter.

An MM LLC must have one director or general director of the company appointed by the BOM, who may or may not be a member of the enterprise. The general director is responsible for the day-to-day operation of the enterprise and can be appointed by the BOM as the legal representative of the company. Similar to an SM LLC, an MM LLC can have many legal representatives, as long as one of the legal representatives resides in Vietnam and must authorize another person if he/she needs to travel abroad. The BOM is the highest decision-making body of an MM LLC and its members' voting rights are allocated in proportion to their respective capital contribution. An MM LLC having more than 11 members must also establish a control committee.

(iii) Joint stock companies (JSC)

A JSC is an enterprise whose charter capital is divided into shares held by three or more organizations or individuals. Shareholders are responsible for the debts and liabilities of the enterprise to the extent of the amount of their contributed capital. A JSC has the right to issue securities in order to raise capital and it may list on a stock exchange if satisfying the stock exchange's requirements. A shareholder can transfer, dispose of or ask the enterprise to buy back its shares in accordance with the Enterprise Law or as stipulated in the enterprise charter.

Similar to an SM LLC and an MM LLC, a JSC can have many legal representatives as long as one of the legal representatives resides in Vietnam and must authorize another person if he/she needs to travel abroad. In cases where there is only one legal representative, the chairperson of the board of management or the (general) director shall be the legal representative of the JSC.

A JSC must have common shares and may have preferred shares and/or issue bonds.

A JSC has the right to select its organizational, managerial and operational structure in accordance with one of the two following methods (except where securities laws provides otherwise):

- General meeting of shareholders (GSM), the board of management, control committee and the (general) director. Where a JSC has fewer than 11 shareholders, and the shareholders being organizations holding less than 50% of the total company shares, there is no requirement for a Control Committee.
- GSM, board of management and (general) director. In this case, at least 20% of the members of the board of management must be independent and an internal auditing committee must be established directly under the board of management.

Is there a restriction on shareholder numbers?

An SM LLC can only have one owner. An MM LLC must have at least two members and no more than 50 members. A JSC must have at least three shareholders and there is no limitation on the maximum number of shareholders. If the total number of shareholders of a JSC reaches 100, such JSC must register to be a public JSC within 90 days from the date of the updated shareholders' register of the company.

What are the key features of a share sale and purchase?

The current Investment Law no longer distinguishes the purchase of shares or equity as a direct or indirect form of investment.

(i) Pre-investment approval

Foreign investors must obtain an approval (M&A Approval) issued by the competent licensing authority if the proposed acquisition falls in either of the following circumstances:

(a) the target enterprise is operating in business sectors where foreign investors are subject to conditions; or

(b) the proposed acquisition will result in foreign investors owning 51% or more charter capital of the target enterprise.

(ii) Other approvals

For an SM LLC and MM LLC, the company will need to subsequently register for the amendment of its ERC to record name of the new owner (for SM LLC) or name(s) of new member(s) (for MM LLC).

For a JSC, the company will need to update the shareholder register to record name(s) of new shareholder(s) and notify if there is any change to the information of founding shareholders or foreign shareholders to the competent licensing authority.

(iii) Private placement

For a JSC, if the shares are acquired by way of private placement, the target JSC must submit an application notifying the competent licensing authority of the proposed private placement (Private Placement Approval) in addition to the M&A Approval. The company has to report the private placement result to the competent licensing authority and amend the ERC to record the increase of its charter capital upon the completion of the private placement. In addition, the company will need to update the shareholder register to record name(s) of new shareholder(s) and notify if there is any change to the information of founding shareholders or foreign shareholders to the competent licensing authority.

What are the key features of an asset sale and purchase?

An onshore enterprise could also acquire some or all of the assets of another enterprise. For this purpose, the assets of an enterprise which may be acquired include the following:

- valuable papers;
- bonds, debts and other forms of borrowing;
- contractual rights and comprising intellectual property rights, including trademarks, industrial designs, inventions, trade names, origin or appellations of origin of goods;
- rights with respect to real property, including the right to lease out, assign, mortgage and use to provide guarantees; and
- items of revenue derived from investment activities, including profits and interest on shareholding, dividends, royalties and all types of fees, and other assets and rights with economic value in accordance with law and international treaties of which Vietnam is a member.

Preliminary documents

Is it customary to prepare a letter of intent or term sheet and, if so, to what extent are they binding on both parties?

A preliminary agreement, such as a memorandum of understanding ("**MOU**") or a letter of intent ("**LOI**"), is not a prerequisite to a merger or acquisition in Vietnam, but serves as a useful tool for the parties to reach an initial 'meeting of the minds.' Due to the potentially different business practices between a domestic Vietnamese enterprise and a potential foreign investor, an MOU or LOI is a means for the parties to flesh out their intentions and assumptions at an early stage.

Does a term sheet, in this context, customarily include provisions on exclusivity, break fee or confidentiality?

- Exclusivity: It is common to include exclusivity provisions in a term sheet.
- Break fee: It depends on the parties' consideration and negotiation on payment method of the transaction.
- Confidentiality: It is common to include confidentiality provisions in a term sheet.

Are exclusivity, break fee and confidentiality provisions supplemented with separately negotiated agreements?

Normally, a term sheet includes fundamental provisions that will be negotiated and detailed by the parties in transactional documents. As such, separately negotiated agreements in relation to exclusivity, break fee(s) and confidentiality provisions are not necessarily required. Having said that, depending on the parties' intention, exclusivity, break fee(s) and confidentiality provisions can be included in the Memorandum of Understanding (MOU) or Letter of Intent (LOI) at the initial stage of the transaction. In some cases, a non-disclosure agreement (NDA) can be separately signed for confidentiality purpose.

Is there a duty or obligation to negotiate in good faith?

Unless there is a binding agreement between the parties, there is no act-in-good-faith duty or obligation, and there is also no provision on recourse or liability under Vietnamese law.

Agreeing to the acquisition agreement

Purchase price

Is a purchase price adjustment common?

Frequency/market practice: rarely; purchase price adjustments are becoming more common.

What type of purchase price adjustment is common (e.g., debt-free, cash-free)?

Frequency/market practice: all types are seen, including working capital adjustment, cash-free debt-free, and NAV adjustments.

Is there a collar on the purchase price adjustment?

Frequency/market practice: rarely; collars are not common. They may be required where one of the parties is a public company.

Who usually prepares the closing balance sheet (where applicable)?

Frequency/market practice: these are usually prepared by the target enterprise.

Is the balance sheet audited (where applicable)?

Frequency/market practice: rarely.

Is an earn-out common?

Frequency/market practice: rarely; earn-outs are more common in private equity transactions when the sellers continue to manage the target enterprise after closing. They are less common where the seller is completely exiting. Earn-outs are commonly capped.

Is a deposit common?

Frequency/market practice: rarely.

Is an escrow common?

Frequency/market practice: fairly common.

Is a break fee common?

Frequency/market practice: rarely.

Conditions precedent

Express Material Adverse Event (MAE) closing condition?

Frequency/market practice: fairly common; this is typically available where there is a long period before execution and completion, or in the case of a foreign seller.

Is the MAE general or specific?

Frequency/market practice: both are seen.

Is the MAE quantified?

Frequency/market practice: rarely.

Covenants

Is a non-compete common?

Frequency/market practice: fairly common.

Is it common to use waterfall or blue pencil methods to interpret contractual provisions?

Frequency/market practice: a blue pencil provision is fairly common.

Are non-solicitation provisions (of employees) common?

Frequency/market practice: fairly common (in conjunction with non-compete).

Are non-solicitation provisions (of customers) common?

Frequency/market practice: fairly common (in conjunction with non-compete).

Are seller restrictions usually imposed on the target business between signing the purchase agreement and closing?

Frequency/market practice: very common.

Is there broad access to books, records, management between signing and closing?

Frequency/market practice: fairly common; we generally get this for private deals.

Is it common to update warranty disclosure or notify of possible breach?

Frequency/market practice: rarely.

Representations and warranties

Materiality in representations — how is it quantified (e.g., by a USD amount)?

Frequency/market practice: fairly common; it is usually quantified by the amount or percentage of the change.

How is knowledge qualified (e.g., specific people, actual/constructive knowledge)?

Frequency/market practice: knowledge qualifiers are growing. They are often limited to actual knowledge and due enquiry of a specified list of members of senior management.

Is a warranty that there is no materially misleading/omitted information common?

Frequency/market practice: fairly common; this is always requested by buyers, but is typically one of the most contested warranties.

Is disclosure of the data room common?

Frequency/market practice: rarely used, but becoming more common.

Repetition of representations and warranties

Is it common to repeat warranties at closing?

Frequency/market practice: fairly common; repetition at completion is common.

Is it common to repeat warranties at all times between signing and closing?

Frequency/market practice: fairly common.

Is a bring-down certificate at closing common?

Frequency/market practice: bring-down certificates are not very common.

What is the applicable repetition standard, e.g., true in all material respects or Material Adverse Effect?

Frequency/market practice: true and accurate in all material respects is common but there is often a carve out for fundamental representations, which must be absolutely true.

Is double materiality common? (a materiality qualification in bring-down at closing and in representation(s))

Frequency/market practice: rarely; double materiality is usually avoided.

Limitations on liability

What is the common cap amount (as a percentage of purchase price)?

Frequency/market practice: it is commonly 100%.

Does the cap (and other liability limitations) apply to the whole agreement or just warranties (or particular terms)?

Frequency/market practice: both are seen regularly.

What are the common exceptions to the cap?

Frequency/market practice: title and authority warranties are the most common exceptions. Due to the unpredictability of the Vietnamese tax system (and tax officials), it is very difficult to have the seller accept an uncapped tax warranty.

Is a deductible or basket common?

Frequency/market practice: rarely, but becoming more common.

Is a *de minimis* common?

Frequency/market practice: fairly common.

How long does seller liability survive?

Frequency/market practice: this differs case by case.

Are there any common carve-outs from limitation on seller liability (e.g., fraud, tax, key warranties)?

Frequency/market practice: this differs case by case.

Is warranty insurance common?

Frequency/market practice: rarely.

Set-offs against claims

Is a set-off against claims for tax benefits common?

Frequency/market practice: rarely.

Is a set-off against claims for insurance proceeds common?

Frequency/market practice: rarely.

Is a set-off against claims for third-party recoveries common?

Frequency/market practice: rarely.

Damages, knowledge

Is there an obligation to mitigate damages?

Frequency/market practice: rarely; this is required by law, but it is not common to incorporate this into the purchase agreement.

Is there an exclusion of consequential damages?

Frequency/market practice: fairly common.

Are provisions that there is no liability if the buyer has knowledge common or does buyer knowledge have no effect?

Frequency/market practice: rarely; they are often silent.

Dispute resolution

Does local law allow for a choice of governing law?

Frequency/market practice: Vietnamese law is preferred for enforcement in Vietnam.

What is the common governing law?

Frequency/market practice: Vietnamese law is preferred for enforcement in Vietnam.

Is litigation or arbitration more common? If arbitration, where?

Frequency/market practice: this differs case by case. If arbitration is used, Singapore and Vietnam are more commonly seen.

Stamp duty and tax

If stamp duty is payable, is it normally shared?

Frequency/market practice: none.

Is a separate tax covenant/indemnity or tax deed common?

Frequency/market practice: it is fairly common to have a tax indemnity, usually included in the purchase agreement.

Global deal points study

Baker McKenzie analyzes M&A key deal terms across a number of jurisdictions allowing us to answer questions on market practice (including by industry) grounded in up-to-date deal data.

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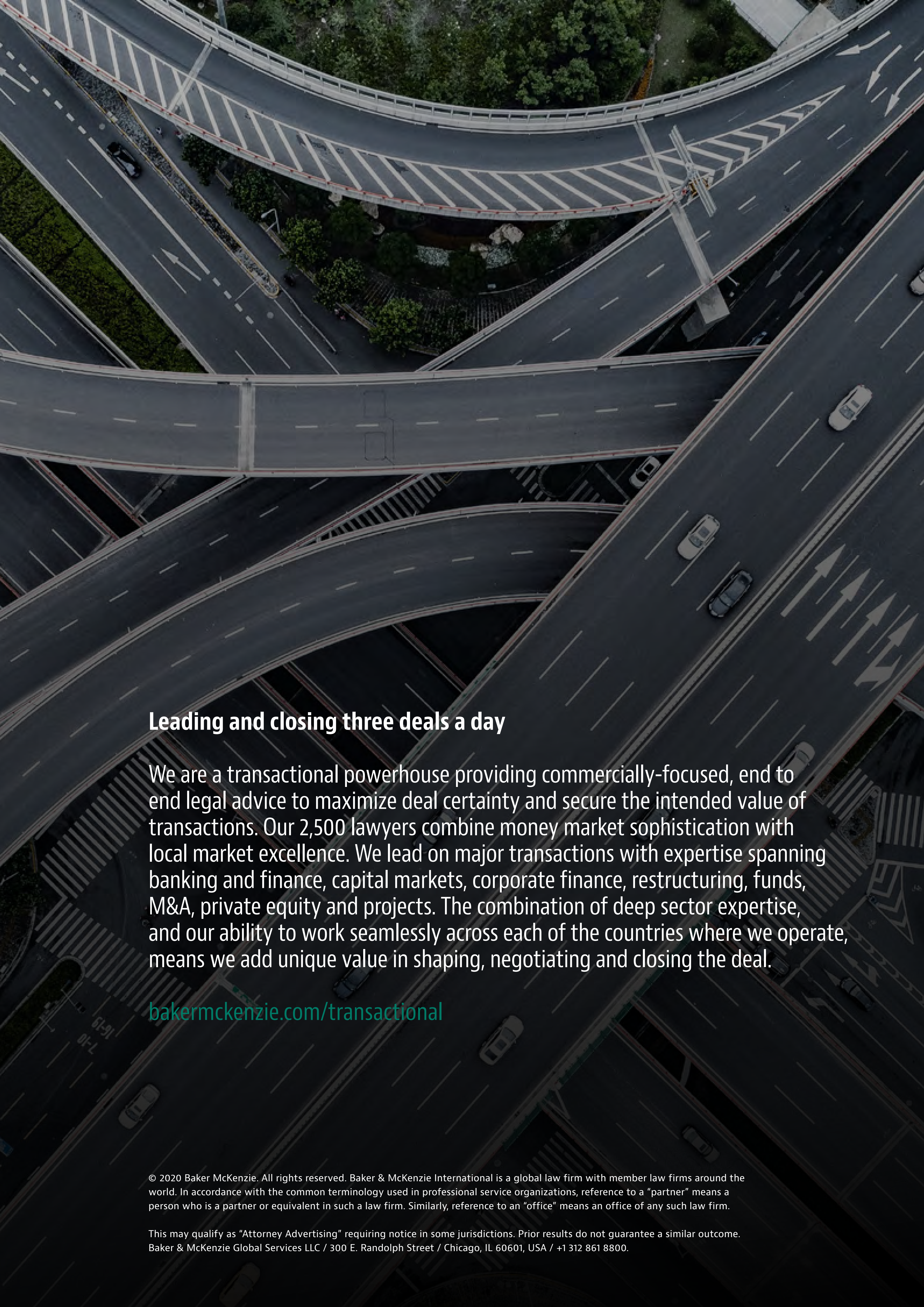

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