

TRANSEO CONFERENCE 2012

Improving SME Transfers



24 & 25 May 2012

Spa, Belgium

Transeo
AISBL

European Association for SME Transfer

16.15 > 17.30 Workshop 3

Legal aspects: identifying good practices in business transfers

Moderator :

Marc Dufosset

Partner, Copilot

Belgium

16.15 > 17.30 Workshop 3

Legal aspects: identifying good practices in business transfers

- **Gaspard Brulé** - Partner, VAUGHAN Avocats, *France*
- **David Ryckaert** - Partner, Simont Braun Lawfirm, *Belgium*
- **Theis Klauberg** - Attorney at law, bnt Klauberg Krauklis ZAB, *Latvia*
- **Hartmut Schneider** - Managing Partner, M & A Strategie GmbH, *Germany & Poland*

16.15 > 17.30 Workshop 3

Legal aspects: identifying good practices in business transfers

Gaspard Brulé

Partner

VAUGHAN Avocats

France

Process not to miss: Preparatory work

The purpose of this preparatory period is to avoid misunderstandings between Sellers and Buyers

•For a Seller

- ✓ Personal issues: capital gain tax / inheritance tax
- ✓ Data room (Seller' s due diligence)
- ✓ Selecting a financial advisor

•For a Buyer

- ✓ Networking (find a target)
- ✓ Financing / Structuring
- ✓ Collecting information on the target and the market

Process not to miss: Letter Of Intent - LOI

- **Main purposes**
 - ✓ Confidentiality / Exclusive right
- **Main provisions**
 - ✓ Price and Method of calculation
 - ✓ Main terms and conditions of the acquisition agreement: conditions precedent, price adjustments, earn out, Reps&Warranties ...
- **Dealing with issues raised by a due diligence report**
 - ✓ Bank covenants
 - ✓ Re-negotiating
 - ✓ Employment matters / Pollution (pitfalls)

Process not to miss: Reach an agreement

A detailed LOI facilitates the drafting of the final acquisition documentation

•SPA

- ✓ Precedent conditions
- ✓ Agreement on price (instalments, Earn-out)

•Reps & Warranties

- ✓ Reps and audited accounts
- ✓ Ceiling, Threshold vs. Deductible, Time limitation
- ✓ Process of indemnification
- ✓ Warranty (Bank warranty, insurance, escrow ...)

16.15 > 17.30 Workshop 3

**Legal aspects: identifying good
practices in business transfers**

David Ryckaert

Partner

Simont Braun Lawfirm

Belgium

Legal pitfalls

- Manage expectations on the disclosure of a data room
 - From the letter of intent
 - Through the due diligence process
 - Until the share purchase agreement

Legal pitfalls

- Knowledge qualifiers
 - Discussion of some standard clauses and their legal consequences

Legal pitfalls

- Limitations on the seller's liability
 - *De minimis*, cap, basket, franchise
 - Bridging the gap using insurance products

Legal pitfalls

- Non compete in family businesses
 - As seller
 - As buyer
 - As advisor

16.15 > 17.30 Workshop 3

Legal aspects: identifying good practices in business transfers

Theis Klauberg

Rechtsanwalt, partner bnt attorneys-at-law

Member of the bar associations of *Estonia, Latvia, Lithuania, and Hamburg*

Contents

1. Economies

2. Legal environment

- Business as usual?
- The devil and the details

3. Practice

- General
- M&A specific

4. Watch out! some examples

5. Dos and don'ts

2011	GDP %	FDI EUR (mio)	Unemployment in %	Concentration cases
Estonia	+3.3	289.9	10.2	10 (2010)
Latvia	+5.7	439	13.1	11
Lithuania	+5	1069	12.5	40

Sources: Eurostat; EBRD; Bank of Estonia; Estonian Competition Authority, Competition Council of Latvia, Competition Council of Lithuania, Bank of Latvia, Bank of Lithuania

Legal- business as usual?

- Re M&A: LT, LV, EE quickly transposed all principal European Community (EC) legislation into domestic law
- M&A came into the Baltics in the 90s, often English terminology used and general processes follow the known standards

Legal – the devil and the details

- Three different legal systems
- Different practices in each country
- Countries in transition
- Still existing practice dating back to Soviet times deviating from the black-on-write of legal texts

Factual particularities – general

- Are there 'The Baltic States'?
- differences

Factual particularities – general (focus LV, LT)

- Seeking of short term gain still prevalent
- Mistrust in (business) relationships more the norm than the exception
- Few trade unions and collective agreements
- Mixing of private (business) interests with political mandates not uncommon

Factual particularities- M&A specific

- Few, since legal systems comparable to Western European ones, EU norms transposed. M&A processes taken from Western countries
- Limited number of large deals
- Vendor LDD still very rare
- Data room: increasingly virtual data rooms
- Prominent role of banks and decision makers within banks in distressed M&A scenarios

Watch out! (examples):

-LT (ongoing): Consulting German buyer re acquisition of public limited company (non listed): negotiations after positive LDD, sellers continue negotiations w/o disclosing the arrest of shares 1 week prior to meeting

-LV: “Motivation” of bank employees might influence, whether deal is possible + which advisors get the case

- Consulting buyer re acquisition of real-estate company from Swedish investor after turn-around of the target (volume: 28 Mio EUR); bank employee “forces” buyer to change advisor due to personal issues with advisor
- Some employees take over assets that the buyer did not want to acquire (e.g. claims)

Dos and don'ts

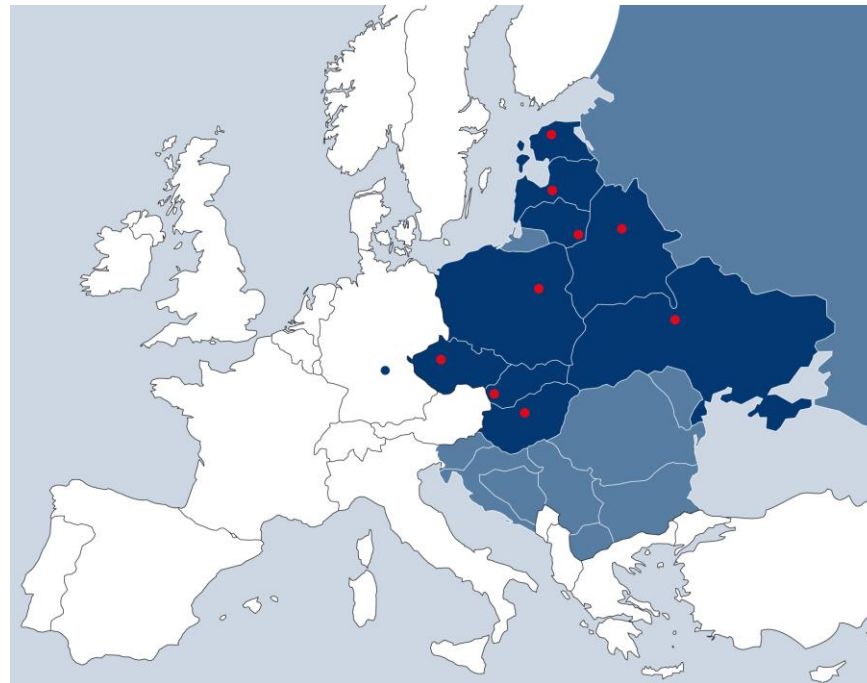
- Inform yourself → don't rush!
- Accept help → don't be proud!
- Accept particularities → don't be ignorant!
- Don't underestimate LV, LT, EE → don't be arrogant!
- Protect your interests → don't be frivolous!

re M&A:

- Don't focus on legal aspects only!

Our Offices

Bratislava
Budapest
Kyiv
Minsk
Nuremberg
Prague
Riga
Tallinn
Vilnius
Warsaw



Cooperation

Bucharest
Moscow
Sofia

For further questions!

bnt attorneys-at-law

Alberta Iela 13, Riga, LV-1010

Tel. +371 6777 05 04

Fax +371 6777 05 27

info.lv@bnt.eu

www.bnt.eu

16.15 > 17.30 Workshop 3

Legal aspects: identifying good practices in business transfers

RA Dr. Hartmut Schneider

CEO

M & A Strategie GmbH, *Germany*

M & A Strategie Polska Sp. z o.o., *Poland*

General Scheme of a Company Sales Process:



Contractual Arrangements

- **NDA: Non-Disclosure Agreement**
 - MoU: Memorandum of Understanding
 - **Lol: Letter of Intent**
 - Exclusivity Agreement / Non-Solicitation
 - **Sale & Purchase Agreement**
- „Ltd.“ in Germany to be Notarized: § 15 GmbHG

Structure of SPA (Sale & Purchase Agreement)

- Parties - Scope of Agreement (Asset Deal / Share Deal)
- Purchase Price - Purchase Price Adjustment
- Warranties & Representations
- Liability , Indemnifications
- Non-Competition / Non-Solicitation
- Merger Control Approval, Confidentiality, Notices
- Cost, Taxes, Exhibits

Pitfalls Crossborder Transactions

In General:

- Different Languages / Different Cultures
- Different Legal Concepts
(Statutory Law, Common Law, Islamic Law ...)
- Different Meanings of the “same” Words:
e.g.: Eigentum, Property, Propriété
- Different Formal Requirements, Notary Acts,...

Pitfalls Crossborder Transactions

Liability of Buyer in Share Deals:

Germany:

- § 25 HGB: Liability for Continuing the Company's Name
- § 75 AO: Liability for Tax Debts
- § 16 II GmbHG: Liability for Pending Shareholder Payments
- Product Liability (Product Liability Act - ProdHaftG)
- Producer's Liability (§ 823 BGB)
- Remediation Duty for Contaminated Sites (§ 4 III BBodSchG)

Pitfalls Crossborder Transactions

Liability of Seller in Share Deals:

- Warranties and Representations of Seller
- Existence and Ownership of Shares
- Corporate Law Issues (AoA, Commercial Register, List of Shareholders, No Insolvency, ...)
- Contractual Relations, Stock Value, Receivables
- Employees, Collective Agreements
- Liabilities; Provisions for Pension Obligations
- Balance Issues and Equity Capital
- Tax Issues
- Change of Control Clauses
- Pending Lawsuits

Pitfalls Crossborder Transactions

Examples of Transaction Risks in Practice:

- Earn-Out Clauses
- Equity Capital Guarantee
- Price Adjustment Clauses
- Lack of Form
- Tax Audit by Tax Authorities
- Pending Lawsuits
- ...

Pitfalls Crossborder Transactions

Earn-Out Clauses I

- Agreement on a Purchase Price Dependent on EBIT
- Why?
 - Evaluation Uncertainty on future Market Development
 - Dependence on few Customers
- Minimum Purchase Price + Subsequent Increase after reaching Contractually Defined Objectives

Pitfalls Crossborder Transactions

Earn-Out Clauses II

- “Too Optimistic” Plans are Dangerous:
 - Buyer makes Earn-Out Installment Payments Dependent on the Achievement of the EBIT-Planning of the Seller up to (3) Years after Closing
 - Buyer - or even Seller (continuing as CEO) - makes high Capital Investment and prevents or reduces Installments
- => Note: Define a Target EBIT as a Percentage rather than a Fixed Threshold:
Otherwise, the Entire Earn-Out Rate is Zero (!)

Pitfalls Crossborder Transactions

Equity Capital Guarantee

- Seller must indeed know his own Company (!)
 - Problem: Unreliable Head of Finance and Accounting
 - Problem: Annual Financial Statements for the Future Transfer Date are made by the Buyer
 - Seller has been rescinded as Managing Director + Former Commercial Director has been rescinded
 - All Documentation only available inside Company
- => Seller: No more Influence on the Financial Statements
- => Evaluations not really litigable

Pitfalls Crossborder Transactions

Price Adjustment Clauses

- Closing Date Concept (Transfer Date) or Effective Date Concept (as in the Past).
- Proposal ↔ Counter-Proposal
↔ Dispute: Arbitrator or Neutral Evaluator decides
e.g.: President of the Chamber of Commerce or the Institute of Chartered Accountants (IdW)

=> Exclusion of a Negative Purchase Price

=> No Liability for future Profitability

Pitfalls Crossborder Transactions

Lack of Form:

- Purchase Agreement: § 15 III, IV GmbHG (Notarization)
Obligations + Additional Agreements (!) +
Assignment (Unity of Business Act)
- Sale of Real Estate: 311 b I BGB (Notarization)
+ Additional Agreements (!) (Unity of Business Act)
- If (only) 1 Party wants to connect different Agreements =>
Notarization
=> § 139 BGB: Severability - In Doubt => Full Invalidity
- Beware of Side-Letters
- Obligation to transfer the entire Property
§ 311 b (II), III BGB (Notarization)

Pitfalls Crossborder Transactions

Tax Audit by Tax Authorities:

- Additional Payments after Tax Audit
- Tax Audit: Long Time after Company Sale
- Company is Liable
- Retention of a final Purchase Price Installment?
- Seller should participate in the last Audit Discussion
- No Influence of the Seller
 - and due to Retention or Warranty Obligations
little Interest of the Buyer to keep Payments low
- => Repercussions for Income Based Price Adjustments!

Pitfalls Crossborder Transactions

Pending Lawsuits:

- Share Deal: Succession of the Company as a whole
 - Proceedings concerning Issues of the Past
 - Patent and Trademark Infringements, etc.
- => Possibly Risk for the whole Company or Business Model
- => Inclusion in Catalogue of Warranties
(Is Seller still able to pay Damages after Years?)
- ⇒ Buyer has to deal with all Pending Law Suits of the Past!

Thank you for attention!

M & A STRATEGIE GmbH

16.15 > 17.30 Workshop 3

Legal aspects: identifying good practices in business transfers

- **Gaspard Brulé** - Partner, VAUGHAN Avocats, *France*
- **David Ryckaert** - Partner, Simont Braun Lawfirm, *Belgium*
- **Theis Klauberg** - Attorney at law, bnt Klauberg Krauklis ZAB, *Latvia*
- **Hartmut Schneider** - Managing Partner, M & A Strategie GmbH, *Germany & Poland*