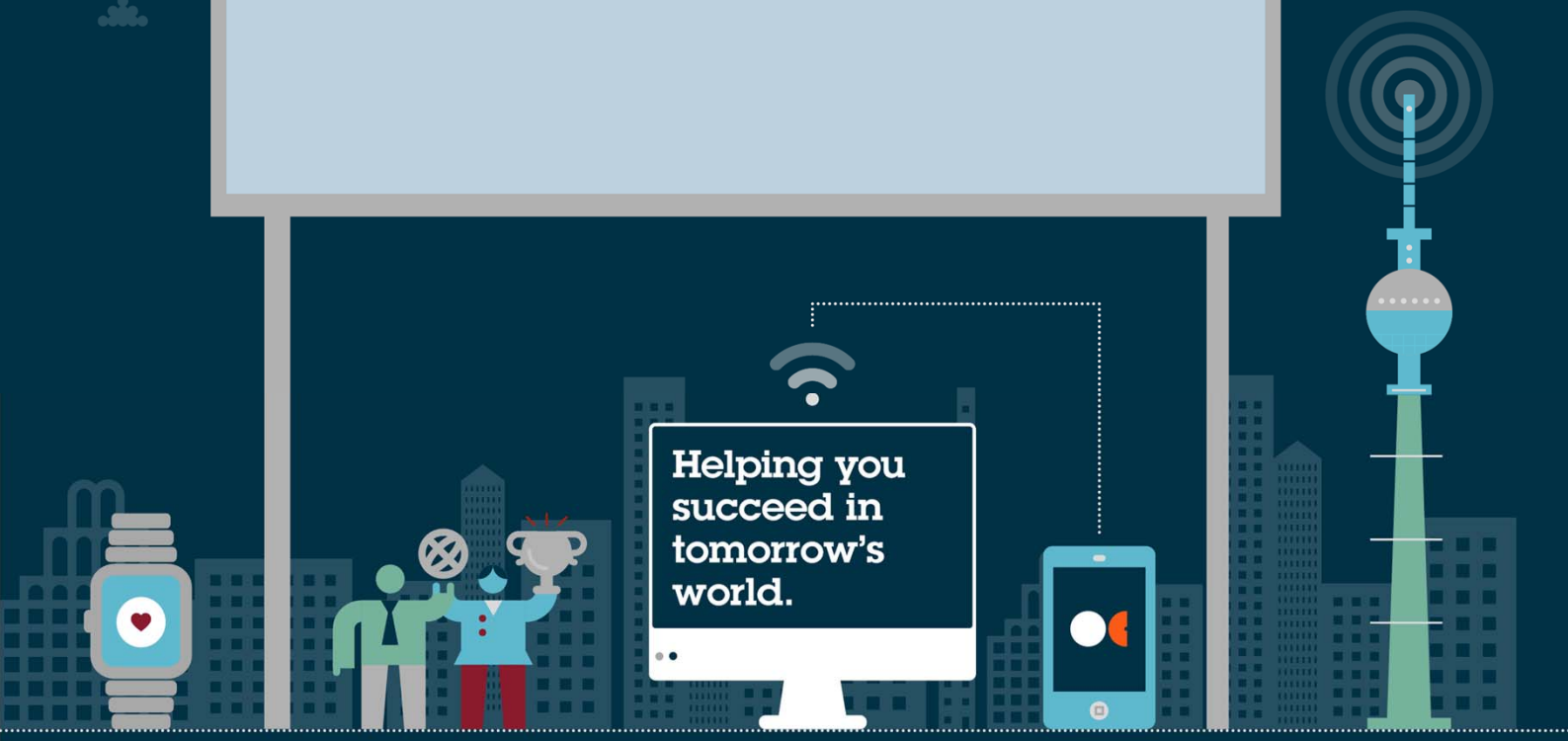
Osborne Clarke

European and US Private M&A: a comparison

2020

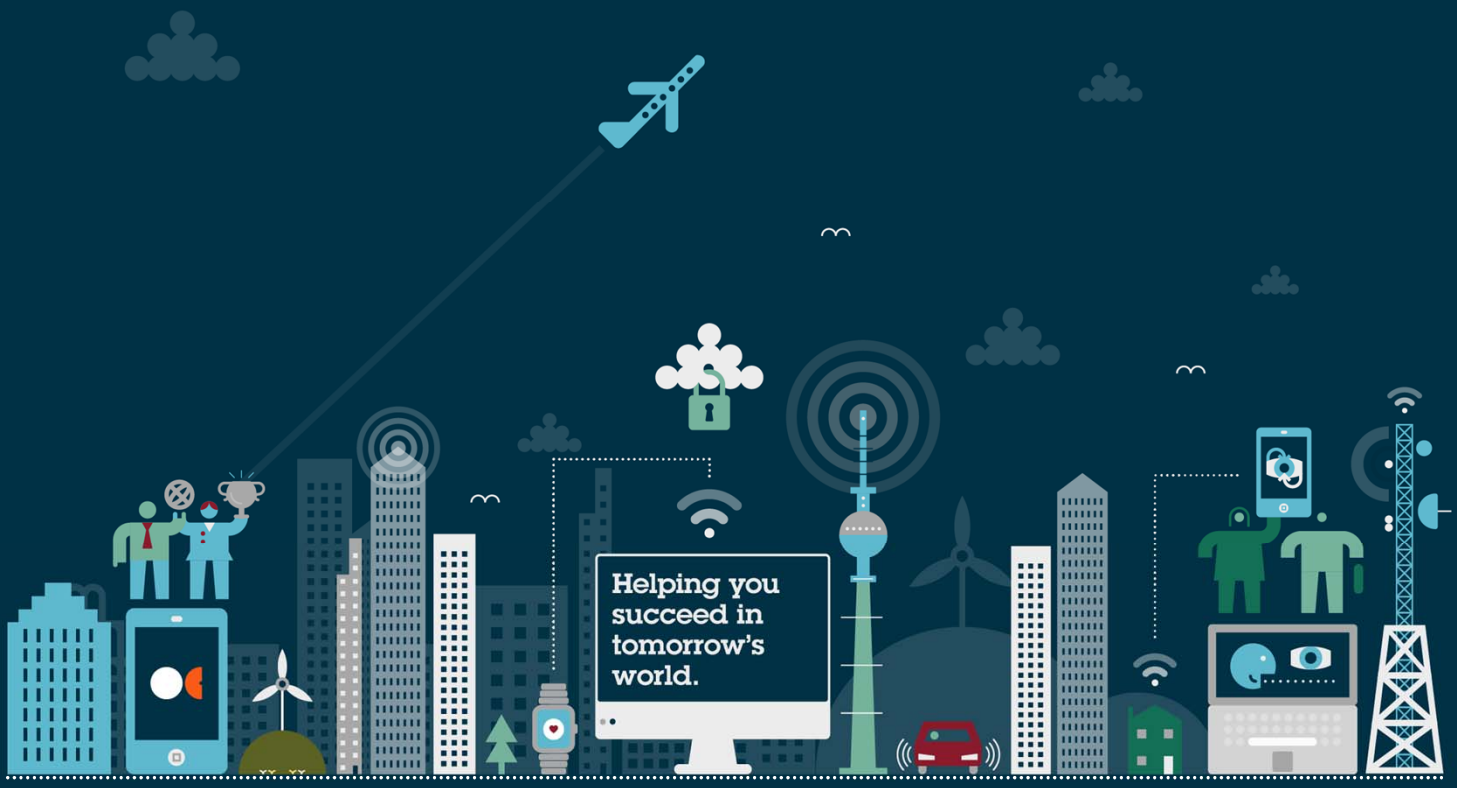


European and US private M&A practice has lots in common – with similar concepts, timings and workstreams. Yet misunderstandings can still arise.

This guide highlights some of the key differences between European and US private M&A practice and is aimed primarily at US parties who are considering doing deals in Europe.

Public company M&A in Europe, as in the US, is covered by separate rules and is not covered in this guide. Please contact us if you would like further information on that.

01 Deal structures



Deal structures

Assets versus Shares

Like in the US, private company M&A in European jurisdictions is usually a contractual process in which the buyer acquires either the shares of the target company from the target's shareholders or the underlying business and assets from the target company itself.

A share purchase is the most common form of acquisition structure in European jurisdictions. It involves the buyer acquiring the issued shares in the target company from the shareholders. Usually a buyer will acquire all of the issued shares in the target, but acquisitions of minority and majority stakes do occur. In a share purchase the buyer assumes all liabilities of the target company whether they know about them or not – often referred to as a "warts and all" situation.

A business/asset purchase acquisition structure is far less common. It involves the buyer acquiring a discrete business division (its assets and expressly assumed liabilities) from the target company itself. Each component of that business is transferred to the buyer and the buyer is able to identify which assets (and specific and expressly assumed liabilities) it will acquire.

An asset purchase is more complex than a share purchase. Additional paperwork is often required to transfer particular assets. There is also a greater need to involve third parties where their consent is required for the transfer to take place.

Mergers

"Mergers", in the sense of a company absorbing or being absorbed into another entity are a domestic feature of some European jurisdictions – such as Spain and the Netherlands – but not others. Notably, unlike the US, the UK does not have a domestic merger regime.

There is however a pan-European cross-border merger regime which provides a relatively streamlined process for a merger between two or more companies registered in at least two different EEA states, but these types of cross-border merger happen relatively infrequently. The EU cross border regime is available to UK companies until at least 31 December 2020 even though the UK has left the European Union. However, it is likely to cease being available after that date.

This guide does not cover domestic mergers or cross-border mergers – please contact us if you would like further information on those.

Deal structures

Auction sales

As in the US, competitive auction sales are a common feature of European private M&A.

An auction process in Europe will typically follow the same process as in the US except that vendor (seller) due diligence is a common feature of European auctions, particularly ones involving private equity sellers.

Vendor due diligence involves the seller hiring legal, financial and other relevant advisers to prepare a number of due diligence reports on the target. These reports are made available to the potential bidders, initially on a non-reliance basis, as part of the auction process as a pre-cursor to access to a full data room which is typically reserved to bidders taken through to the second stage of the process to allow the bidders to conduct some confirmatory due diligence.

Once the sale process has completed, the ultimate buyer is permitted to rely on the report on terms agreed with the due diligence providers including on matters such as caps on liability and other standard limitations.

Tax

As in the US, the deal structure in European jurisdictions will need to accommodate the differing tax objectives of each party.

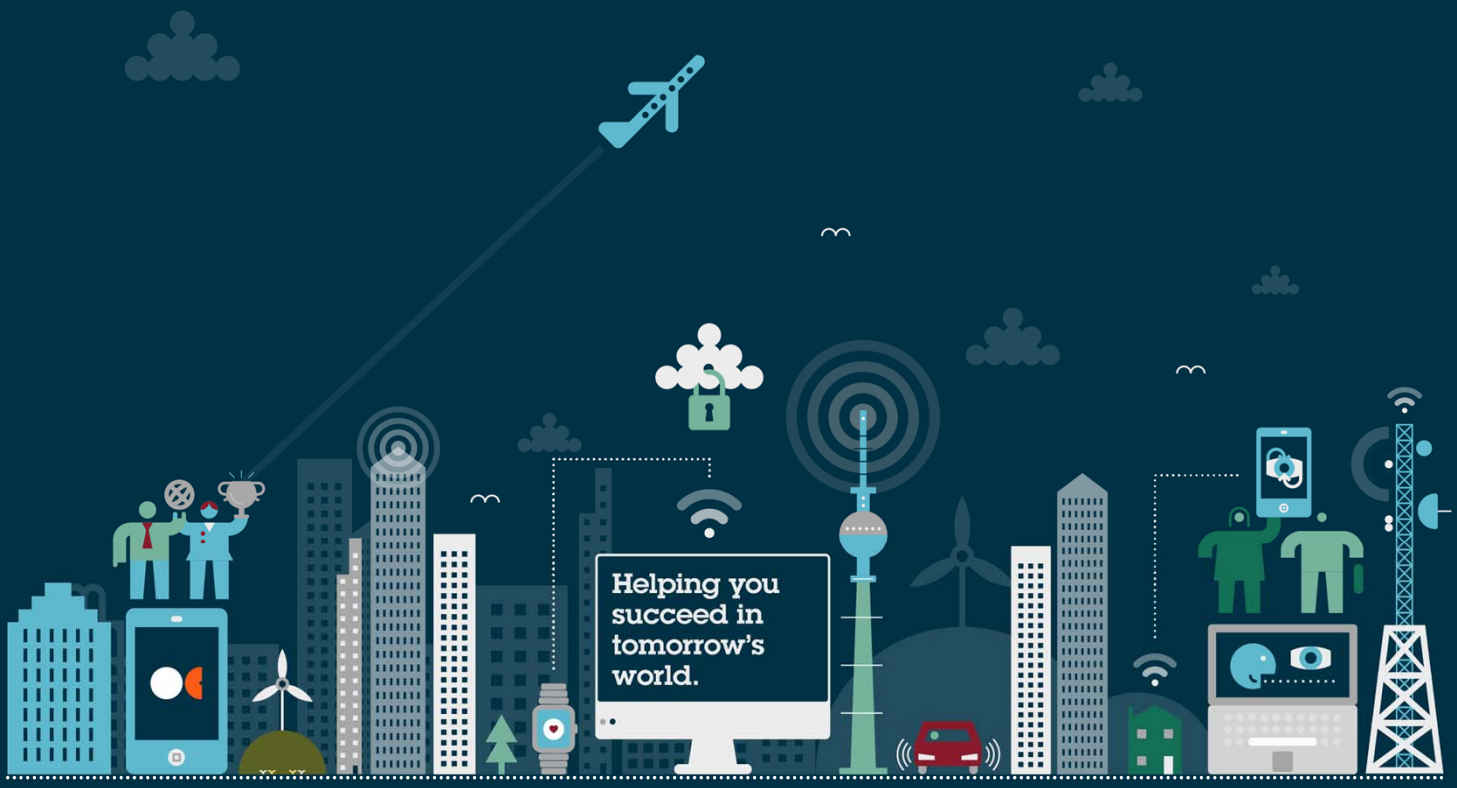
Invariably sellers will want the sale to come within the capital gains tax regime rather than income tax and in some cases, clearance from domestic tax authorities may be required to obtain comfort that this will be the case. Where required this will need to be factored into the deal timetable.

Merger control issues

Merger control or anti-trust filings/approvals can also feature in a number of European jurisdictions such as Germany where the thresholds for merger control filings are relatively low. In other jurisdictions, such as the UK, there is a voluntary notification regime though where competition is likely to be an issue it is usually advisable to make a protective filing and seek clearance where the transaction falls within the jurisdiction of the relevant regulating body.

Merger control clearance is one of the more common reasons to have a conditional sale and purchase agreement involving a split exchange and completion.

02 Acquisition terms

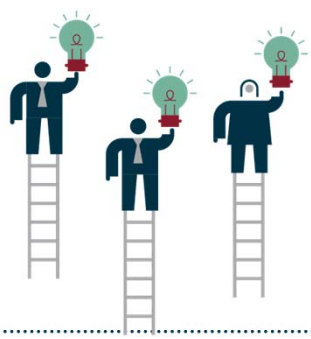


Acquisition terms

Initial stage documents

These are similar in style and content to initial stage documents used in the US.

Type of document	Commentary
Non-disclosure agreement (or an "NDA" or "confidentiality agreement")	This requires each party and its advisers to keep information (including the existence of negotiations) confidential throughout the transaction. Confidentiality provisions are often coupled with non-compete/non-solicitation covenants so that the buyer cannot use the confidential information it has received for its own purposes.
Exclusivity agreement (or a "no shop", "lock-out" or "shut-out" agreement)	This protects a buyer during the negotiation and due diligence phase by prohibiting the seller from dealing with other potentially interested parties.
Heads of terms (or "letter of intent" or "memorandum of understanding")	This summarises the proposed terms of the deal. The contents are not usually legally binding, except where confidentiality undertakings, non-compete/non-solicitation covenants and/or exclusivity provisions have been wrapped up into the same document. Similar to the US, in some European jurisdictions – such as Germany, France, the Netherlands and Italy – there is an overriding obligation on the parties to negotiate in good faith. In contrast, there is no such general good faith obligation under English law.



Acquisition terms

Acquisition document

In Europe, as in the US, the share purchase agreement (or "stock purchase agreement") is the principal acquisition document that records the terms of the transaction.

The style of agreement and drafting approach can vary across jurisdictions in Europe. UK agreements tend to be longer with extensive warranties and indemnities – similar to US agreements, due to the common law system (i.e. judge made) which applies in those jurisdictions. Most other European countries (including France, Germany, Italy and the Netherlands) have a civil law system – where much of the law is codified – and they tend to have shorter agreements because the civil codes already imply some protections for the buyer. Having said that, most civil law jurisdictions are familiar with US/UK style agreements and there is an increasing amount of convergence between the two particularly in cross-border transactions.

Differences in practice between Europe and the US are examined in detail below.

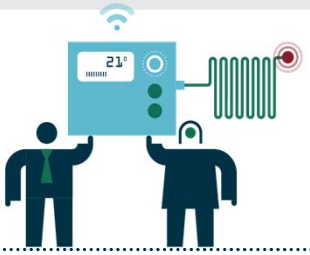
Issue	Commentary
Representations and warranties	It is usual in both the US and Europe for the seller to give warranties in respect of the target company/business. These are statements of fact which if untrue will give the buyer the right to claim for its loss. Warranties may not always be as extensive as in the US; the range of warranties offered in an auction draft sale and purchase agreement are typically much more limited. In the US, such statements are commonly referred to as reps and warranties. But in some European jurisdictions, such as the UK, a seller will resist referring to them as representations as this will widen the legal remedies available to the buyer beyond contractual remedies.

Acquisition terms

Issue	Commentary
Buyer's knowledge	In the US, a buyer may seek to include a pro-sandbagging clause in the agreement – which allows it to bring a claim for breach of warranty notwithstanding that it had prior knowledge of that breach. In some jurisdictions, including the UK and the Netherlands, such clauses may not be enforceable: a buyer would typically seek specific indemnity cover from the seller or a reduction in the purchase price in respect of known issues instead. In addition, it is not uncommon in a number of European jurisdictions to have specific anti-sandbagging provisions which prevent the buyer from pursuing recovery for matters that can be shown to be within the knowledge of the buyer prior to signing.
Basis of recovery	As in the US, the basis of recovery for breach of a warranty in some European jurisdictions – including France, Italy and Spain - is typically on an indemnity basis so the buyer can make a dollar for dollar recovery of its losses. In other jurisdictions – including the UK and the Netherlands – the basis for recovery will typically not be on an indemnity basis other than in relation to tax. Recovery will instead depend on how the breach has affected the overall value of the target or the buyer may be able to recover loss of profit. There may also be duty on the buyer to mitigate (i.e. minimise) its loss – this applies under English law and Dutch law for example. The parties can provide for separate indemnification rights to cover specific disclosed risks (where no general duty to mitigate loss exists) but indemnification would not usually apply across the board. As a result, it may be more difficult for the buyer to recover all of its costs in the event of a breach – and consequently more emphasis is placed on pre-contract due diligence.

Acquisition terms

Issue	Commentary
Escrows	Escrows (or retentions as they are sometimes referred to in the UK) are common in the US, particularly where the seller is a private equity sponsor, to back-stop the seller's liabilities under the sale and purchase agreement, particularly the warranties and representations. Escrow practice varies in European jurisdictions. In some, such as the Netherlands, escrows are often used to give security to the buyer if W&I insurance is not used. In others, such as the UK, escrows are not the norm and, where they are used, the seller's potential liability will usually extend beyond the escrow terms and amount in contrast to practice in the US where the escrow may be the buyer's only recourse. Escrow agents are commonly used in Europe, like in the US, to hold escrow funds on behalf of the parties.
Limitations on seller's liability	Like US deals, European deals will also include an overall cap on the seller's liability for breach of the warranties. But on average European deals feature a higher cap than US deals. For example, in the UK, it is not unusual for the cap to be set at 100% of the purchase price though it is becoming increasingly common to cap at less than 100% other than in relation to the fundamental (title and capacity) warranties. European deals also feature a basket – the level of damages which have to be reached before the buyer can bring a claim for breach of warranty. This may follow the US style of a deductible basket (only a claim for the amount exceeding the level of the basket may be brought) or a tipping basket (once the threshold has been reached, the full amount of the claim may be brought). In some European deals, for example in the UK and the Netherlands, it is also common to see an individual de minimis or a mini-basket level set – any claims below this level will be disregarded and not count towards the basket at all.



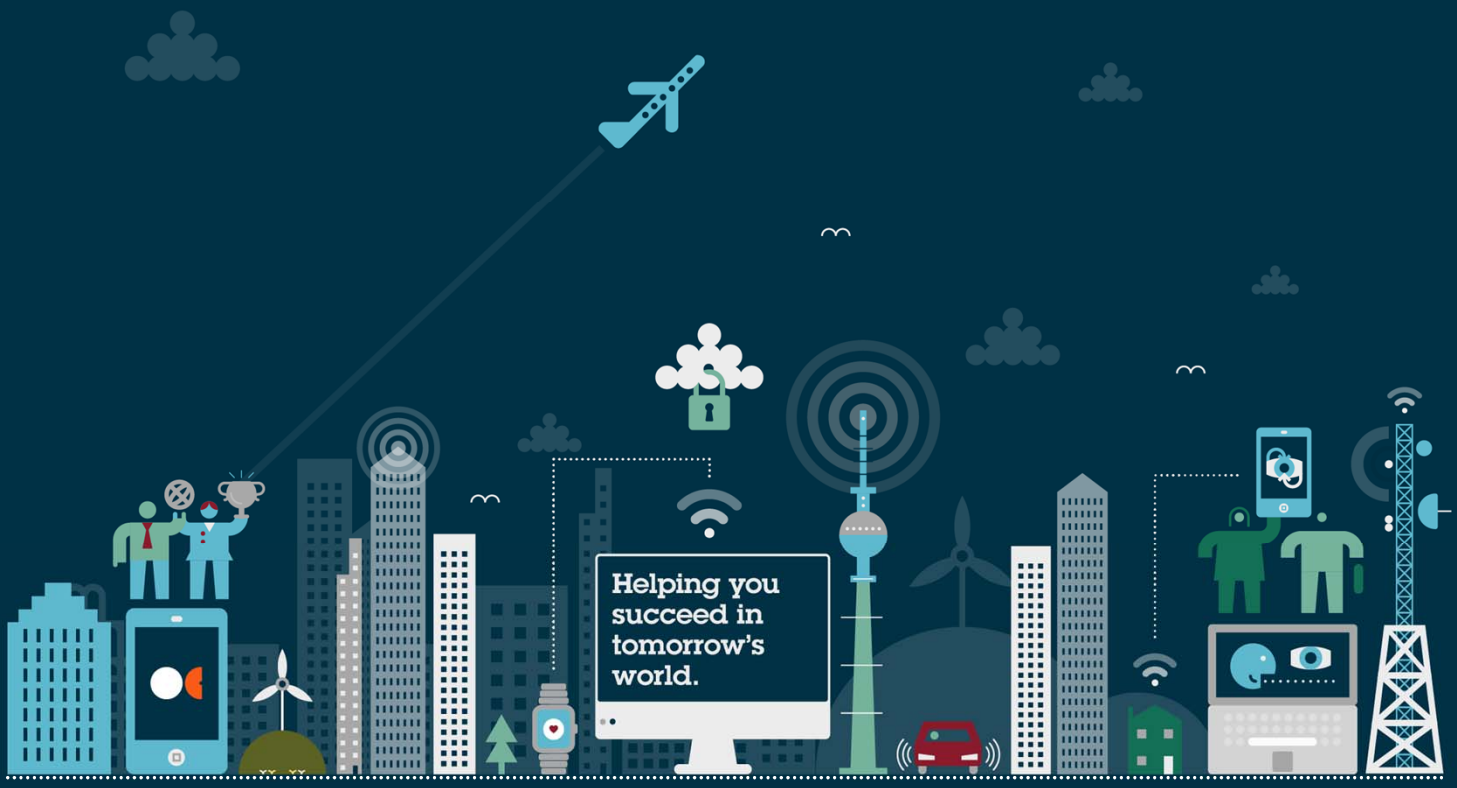
Acquisition terms

Issue	Commentary
Disclosure	Some European jurisdictions such as France treat disclosures – exceptions to the warranties – in the same way as the US, by attaching them as schedules to the share/stock purchase agreement itself. However in many other European jurisdictions, including the UK, Italy, Spain, the Netherlands and Belgium, disclosures are set out in a separate disclosure letter from the seller to the buyer. In some jurisdictions, including the UK and the Netherlands, it is market standard to allow the seller to make general disclosures of information that is available in public registers and it is also common to see a general disclosure of information and documents which were provided to the buyer during due diligence (for example, by general disclosure of the contents of the data room).
Conditions	Whilst European deals do sometime feature a split exchange (signing) and completion (closing), US style closing conditions, wide-ranging material adverse change (MAC) clauses and the bringing down of warranties at closing are not a typical feature of European private M&A. In European M&A, conditions are usually limited to obtaining regulatory or anti-trust consents: conditions which are solely for the buyer's benefit, such as financing marketing conditions, would not usually be accepted. Reverse termination or reverse break-up fees are also not used. Any financing risk is borne by the buyer who is expected to enter into the transaction on a "certain funds" basis – and a seller may wish to see evidence of that. As fewer deals are conditional, MAC clauses are also less common. Where they are used, they are frequently narrowly drafted and target specific. In some jurisdictions, it is also less usual to repeat warranties at completion except perhaps fundamental warranties relating to title and capacity.

Acquisition terms

Issue	Commentary
Price adjustments	European M&A deals do often feature US style purchase price adjustments - by reference to completion accounts drawn up after completion. However, European M&A deals will frequently use a locked box structure – where the price is determined in advance of signing based on a balance sheet drawn up to a specific locked box date that is before completion. The seller will undertake that, other than disclosed and pre-agreed sums, there has been no "leakage" in value from the target to the seller from the locked box date to completion and will be obliged to repay any leaked sums. The buyer then takes the risk and reward of the target's performance from the locked box date to completion. The locked box provides greater certainty around the economics of the deal and typically favours a seller. Locked box structures are most common in auction sales.
Restrictive covenants	European deals feature similar post-completion covenants as US deals. Sellers in European deals will typically expect to give non-competition and non-solicitation covenants covering the target's customers, suppliers and employees. However, the scope of these covenants will depend on local law requirements and may not be as extensive as expected in the US. For example, in Europe, it is rare for non-compete covenants to be given for longer than 3 years because they may not be enforceable, whereas 3 to 5 year covenants are common in US deals.

03 Common issues



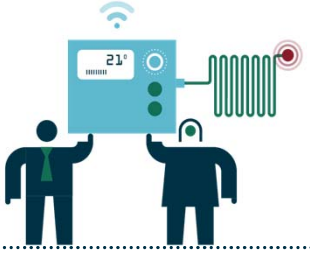
Common issues

Aside from the deal terms, there are some other common issues which can arise in European M&A which are not always a feature of US M&A.

Issue	Commentary
Closing formalities	European deals often feature greater formality around closing compared with US deals. In the UK, certain of the acquisition documents are usually executed as "deeds" instead of simple agreements. Deeds are a special form of document which must be signed in front of a witness. Notarisation is required in some European jurisdictions such as Germany, the Netherlands, Italy and Spain (though not in the UK). This usually requires the final documents to be presented to, and to be read out by a notary in the presence of the parties in person (or by their representatives). Where needed, the costs and time for notarisation will need to be factored into the transaction. US style closing legal opinions – confirming that the relevant party is duly constituted, has capacity to enter into the deal documents and that the transaction is valid, binding and enforceable - are not usually required in European deals. Funds flows will need to be considered as part of closing. In some jurisdictions, as in the US, use of paying agents to manage the funds flow is common. For example, in the Netherlands, this is commonly handled by a third party notary account. In other jurisdictions, such as the UK, paying agents are relatively rare and funds flows are handled between legal advisers.

Common issues

Issue	Commentary
Anti-trust / national security clearance	Many European jurisdictions - including Belgium, France, Germany and Italy - have mandatory notification/approval requirements if the deal meets domestic merger control thresholds. Other jurisdictions, such as the UK, maintain a voluntary notification system – though notification is recommended if thresholds are met. In addition to domestic rules, there is a mandatory EU-wide merger control regime. In recent years, some European jurisdictions – including Germany, France and the UK - have introduced or strengthened US CFIUS-style controls on foreign investment on national security grounds. And the first step has been taken towards EU-wide controls with the introduction of an EU framework for screening foreign direct investment. Where merger control or foreign investment controls are relevant, this will need to be factored into the deal timetable and transaction risk analysis.
Employee consultation	In many European jurisdictions, including Germany, the Netherlands and France, employee representative committees or works councils have compulsory information and/or consultation rights in respect of share sales. Exact requirements vary from jurisdiction to jurisdiction but employee engagement will need to be factored into the deal timetable. On top of domestic rules, the EU-wide transfer of undertaking (protection of employment) regulations and/or the Acquired Rights Directive apply to all business asset sales in Europe. Under these rules, employees working in the target business will transfer automatically to the buyer and a consultation process must be undertaken with them.



About Osborne Clarke

Our global connections and 'best friends'

Through a network of 'best friends' we extend our reach across the globe, particularly in North America, EMEA & Asia Pacific. We have worked closely with like-minded firms in over 100 countries. We'll find the right local partner for you and wherever that may be, we will make sure that you receive the Osborne Clarke level of service.

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Sweden: Stockholm

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China: Shanghai

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