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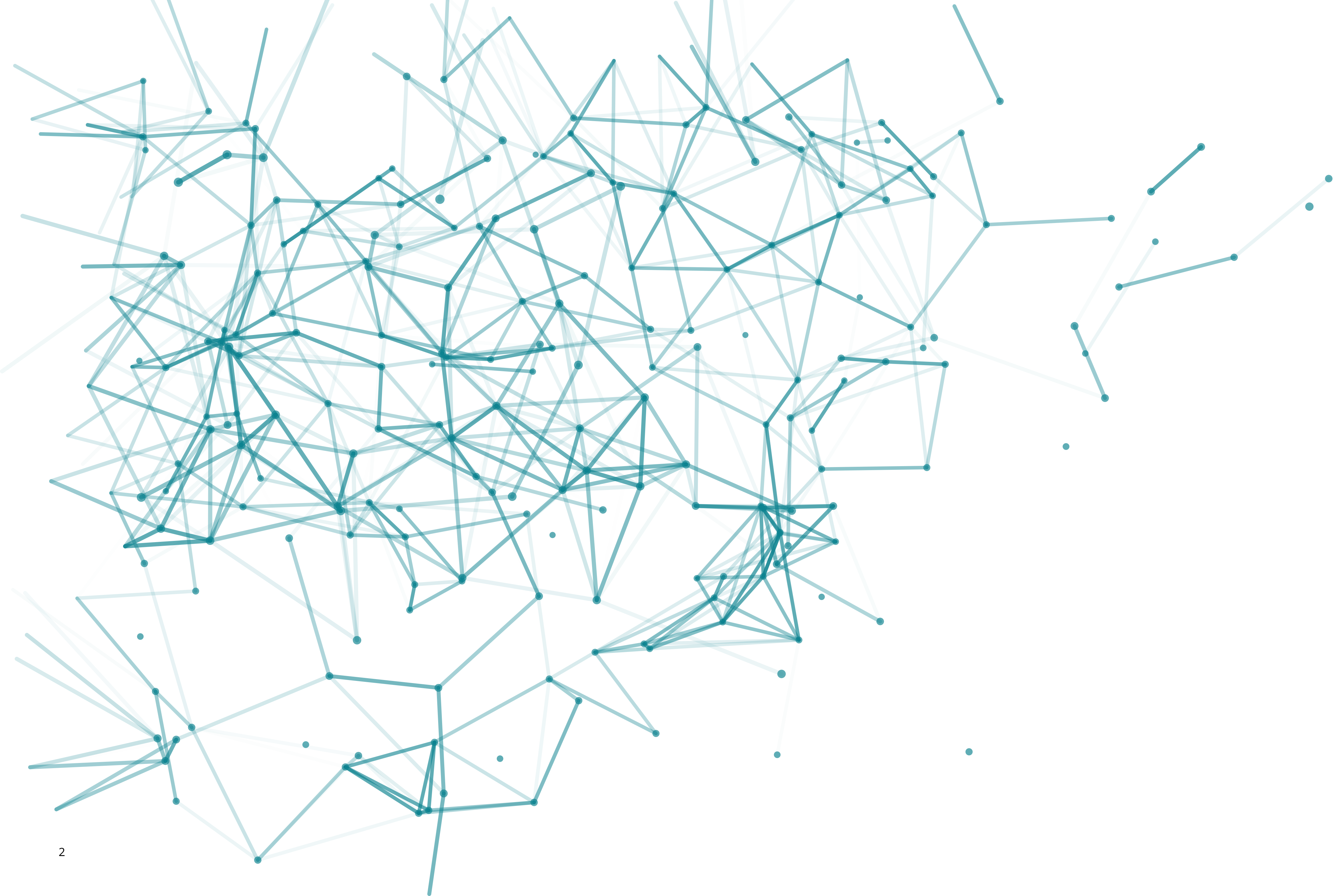
# Deal making in the Czech Republic

## A closer look at SPA negotiations

August 2020







# Introduction

The share purchase agreement ("SPA") is the last stage of any M&A negotiation and a culmination of the parties effort to reach the deal. The document outlines the key financial and commercial conditions, takes into account due diligence findings, and distributes the risks and upsides between the parties. A well-drafted SPA is central to any successful transaction.

Negotiation of the SPA can be a lengthy and intricate process as both sides of the transaction wish to secure the best terms and conditions. Hard won compromises often result in elaborate clauses being introduced in the SPA. As such, SPA is a very complex and sophisticated document which needs to be prepared with utmost care as even a single sentence may make the difference between transaction success or failure. Having an experienced advisor team on your side is vital to avoid the latter.

An SPA usually covers a wide range of areas as it aims to address all material matters related to the target, deal structure and more. The more complex the deal, the more robust the SPA can get. Inexperienced vendors and acquirers are often staggered by an SPA's magnitude and level of detail.

In this study, we address key financial, tax and legal considerations which should be taken into account during the negotiations. We have gathered information from M&A deals on which Deloitte advised in recent years. In the selection of deals, we limited ourselves to acquisitions/disposals of targets located in the Czech Republic in order to provide a unique insight into the local M&A landscape. While talking about M&A it is difficult to avoid the topic of COVID-19. In 2020 the global economy was hit by the pandemic and it is expected to cause the deepest GDP decline since the Great Depression. As we write this, a number of countries are gently easing strict lockdown measures put in place to mitigate the impact of the pandemic. And so the strong backdrop which had been so conducive to deal doing in the Czech Republic – the record low unemployment, the liquid leverage markets, strong GDP growth – is no longer in place anywhere.

The Czech National Bank completely changed the course of its monetary policy: it tried to curb rising inflation by a rate hike in February, but interest rates were subsequently cut three times in under two months as a response to the macro shock, and the main policy rate stood at 0.25% at the time of the writing of this study. Private consumption, long a driver of Czech economic might, is expected to be hit hard by the job losses and uncertainty, and this will knock a strong blow to the economy. The country's exports will be heavily hit by severely reduced demand from the EU, and the Czech economy is forecast to shrink by 8% in 2020.

While uncertainty persists and M&A activity cooled down in the first half of 2020, there are signs of positive momentum in Czech M&A. Also, across the wider investment backdrop, we may see a fresh approach to deal structuring, with higher equity cushions and broader use of earn-out mechanism which would enhance the price tag negotiation. Sellers and buyers may expect that use of MAC, force majeure, break up fees, data room disclosure repetition, earn-outs and hold-backs, insurance, a number of indemnities and representations & warranties will become a subject of more intensive negotiations and part of the transaction documentation. We also expect that in the post-COVID-19 period buyers will more often opt for closing accounts which are typically used in volatile economic environments.

This is our first edition. Our ambition is to report on these matters periodically going forward and hope you will find this document useful.

**Dušan Ševc**
Partner
Deloitte



**Deal making in the Czech Republic** | Closer look on SPA negotiations

# Executive summary

- Closing accounts remain a more popular closing mechanism for M&A transactions in the Czech Republic than locked box, in particular in small to mid-size deals.
- Contrary to public belief, about a **third** of locked box financials did not require external audit.
- About **half of the deals** were settled by the buyer at closing while the other half included some element of deferred payment or earn-out. In the post-COVID-19 climate, we may witness broader use of earn-out mechanisms which would enhance the price tag negotiation.
- The data room disclosure form of seller's liability limitation has been expressly agreed to in **94% of the deals** and is therefore a key instrument to limit the seller's liability under the representations & warranties. In the vast majority of the deals, the sellers agreed to repeat the representations & warranties on the closing date.
- The basket threshold generally does not exceed 3.3% of the purchase price. A first dollar basket threshold appeared in **77% of the deals** while an excess only basket threshold had been agreed to in only **11% of the deals**. No basket threshold was set in **12% of the deals**.
- A de minimis threshold generally does not exceed 0.35% of the purchase price.
- The prevailing liability cap for breaching representations & warranties other than the fundamental warranties was 10% of the purchase price.
- Indemnities were negotiated and included in **73% of the deals** showing that, in the majority of cases, substantial risks were identified within the data room review process but the parties agreed not to reflect them directly in the purchase price.
- Almost two thirds of tax representations & warranties were declared for a period longer than 3 years, i.e., longer than the applicable general statute of limitations in the Czech Republic.
- A tax indemnity was agreed to in **42% of the deals**, out of which about one third represented full tax indemnities, while the remainder represented specific tax indemnitites.
- About one third of deals miss gross-up clauses leading to a risk of additional tax burdens for the parties to the SPA if tax withholdings or deductions materialize.
- **62% of the deals** included pre-closing termination rights, mainly MAC clauses (in **38% of the deals**), followed by breach of representations & warranties (in **28% of the deals**), and breach of interim covenants (**22 % of the deals**).
- In the Czech Republic, arbitration (**59% of the deals**) was more popular than state courts (**41% of the deals**) due to (i) the ability to choose arbitrators, (ii) generally faster proceedings, (iii) flexibility of the proceedings and language used, and (iv) the effect of choosing a neutral venue.
- Non-compete provisions were included in **47% of the deals**.

# Closing accounts remain more popular closing mechanism for M&A transactions in the Czech Republic.

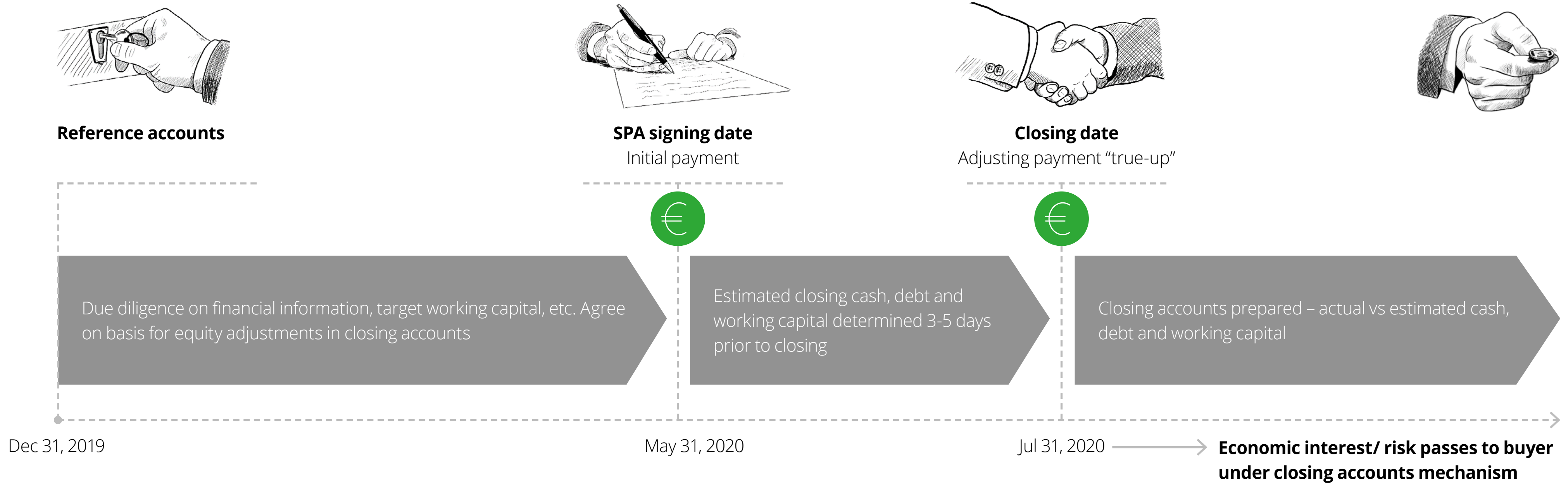
## Benefits of closing accounts

- Economic risk transfers when buyer gains control
- Accuracy of the final purchase price due to post-completion verification of price
- Price reflects target‘s performance up to closing
- Suitable for highly seasonal/volatile business or for carve-out M&A deals
- Globally accepted closing mechanism

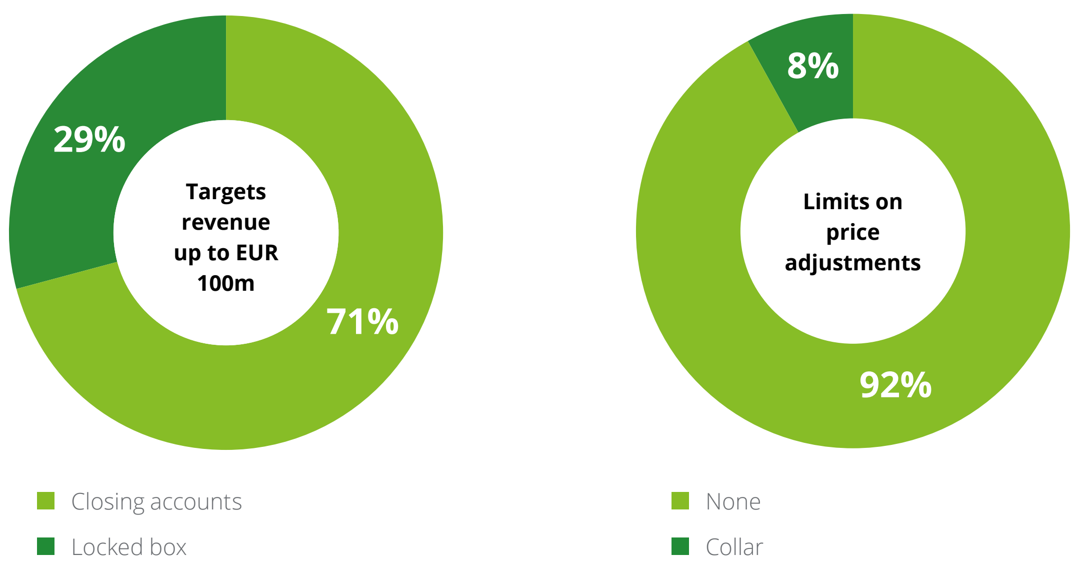
## Closing accounts

- A traditional closing mechanism for M&A transactions, closing accounts (sometimes called "completion accounts") are special purpose transaction accounts which give the parties an opportunity to adjust the purchase price based on the closing accounts figures. Purchase price adjustment protects the buyer from value erosion of the target until the closing date while at the same time allows the seller to enjoy the economic benefit of the business until the closing.
- We observe that closing accounts are a preferred purchase price mechanism in deals involving small to mid-size targets, despite its higher costs. Our study shows that **71% of the deals** involving targets that generated up to EUR 100m revenue were settled using closing accounts.
- Although target size should not be the key buyer consideration, it may be a good indicator of a target's operating maturity and may have an impact on the buyer's confidence in the target's financial accounts. Closing accounts are often used when such confidence is weak to tackle potential risks like low quality of financial statements or robustness of accounting policies and system. By their nature carve-out deals also require closing accounts mechanism to reflect the actual debt, cash and working capital in the carved-out business as at the closing date. Lastly, buyers typically opt for closing accounts over locked box when a target's business is highly seasonal or volatile, as closing accounts enable the capture of a potential decline in a target's performance, while locked box does not. This may become an increasingly important factor to take into account in M&A negotiations in the post-COVID-19 pandemic environment and we may thus be potentially seeing even a higher number of closing accounts deals in the future.
- It is less common for the parties to limit the size of the purchase price adjustment. Our study shows that only 8% of all closing accounts include a collar element – effectively a limit on both the upside and downsize adjustment to purchase price.
- The downfall of closing accounts is the fees, SPA complexity, time-consumption and costs to both parties to negotiate the details of the mechanism and execute on them. Poorly drafted purchase price adjustment mechanisms could potentially give rise to disputes between the buyer and the seller.
- Parties also typically set a mechanism to appoint an independent accounting expert to solve potential SPA disputes arising from the review of the closing accounts.






## Closing accounts statistics



# Contrary to the public belief about a third of locked box financials did not require audit.

## Benefits of locked box

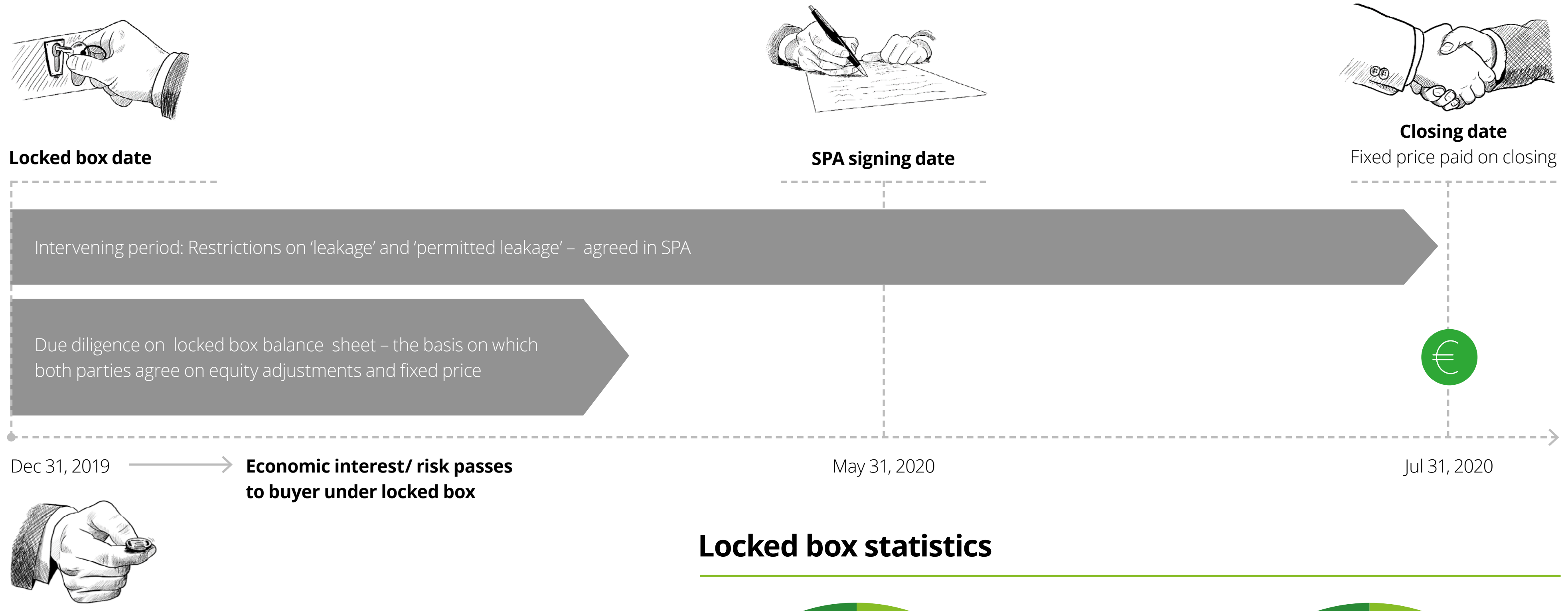
- Purchase price certainty
- Simple transaction structure
- Less time consuming compared to closing accounts
- Easier to compare offers in the context of an auction
- Cost savings due to no closing accounts contracting and review requirement
- Clean break on completion (seller)
- Facilitates quicker integration post-completion (buyer)

## Locked box

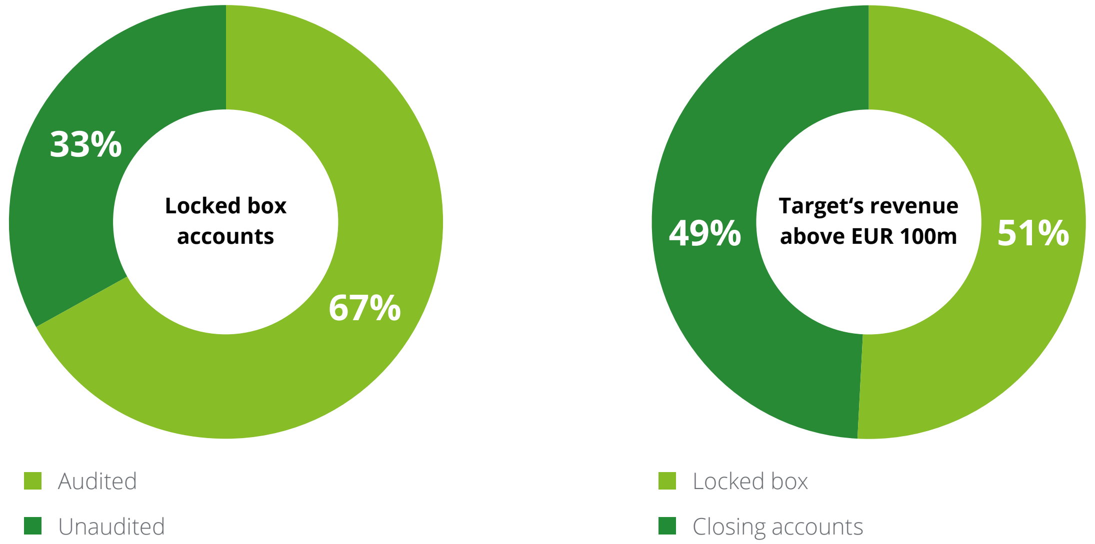
- This is a popular closing mechanism for M&A transactions in Europe due to its simplicity and price certainty. Under the locked box the equity price is fixed and is typically based on the most recent set of audited financial results.
- Our study shows that the larger the deal, the higher the likelihood of the agreement between the parties on the locked box. Specifically, the locked box was introduced in approximately half of all large-size transactions where the target generated more than EUR 100m revenue. The reliability of locked box financial statements is often linked to robustness of the finance function which generally grows with the increasing size of the target. Of all deals about a third of locked box financials were, however, not audited and management accounts were used instead. In most cases these transactions were either concluded prior to the year end or were of a smaller size, less complex and the buyer was sufficiently comfortable with the seller's finance function and reporting and did not require additional audit. In these instances, however, the buyer sought more extensive warranty cover in respect of unaudited accounts (for example, consistent preparation with the most recent audited financial statements).
- Price certainty is attractive primarily for a seller as he/she knows the purchase price at the date of signing while the buyer takes the risk of potential business deterioration between the locked box date and closing. Since there is no post-closing adjustment, buyers undertake extensive pre-closing due diligence to address such risks in SPA provisions.
- The economic benefits and risks pass to the buyer on the locked box date; hence the buyers typically seek to minimize the time between the locked box and the closing date. Our study shows that the time between the locked box date and closing date was typically between 3-5 months.
- During this intervening period the seller commits not to extract any value from the business (called "leakage") unless explicitly permitted in the SPA. Typical leakage items are any dividends and other equity reduction payments, intra-group transactions outside of the ordinary course of business and costs related to the transactions governed by the SPA. The buyer needs to carefully fine-tune the definitions of leakage and permitted leakage in order to protect the value of the target.
- Since the buyer has the benefit of cash profits generated in the intervening period, the seller might seek to negotiate an 'interest compensation' or 'value accrual' for the opportunity cost. In theory it would equal cash profits generated by the target between the locked box date and closing. Our study shows less than 25% of sellers were successful at negotiating an interest compensation.
- **Price considerations for a locked box are exactly the same as the closing accounts mechanism, only the timing differs.**








## Locked box statistics



## About half of the deals were settled by the buyer at closing while the other half included some element of deferred payment or earn-out. In post-COVID-19 climate, we may witness broader use of earn-out mechanism which would enhance the price tag negotiation.

### Benefits of deferred payments and earn-outs

- Bridge the price gap
- Solution for negotiation deadlock in post-COVID-19 climate
- Motivation for the sellers
- Enhancement of buyer's cash position
- Financial protection to the buyer for representations & warranties claims, indemnities and purchase price adjustments

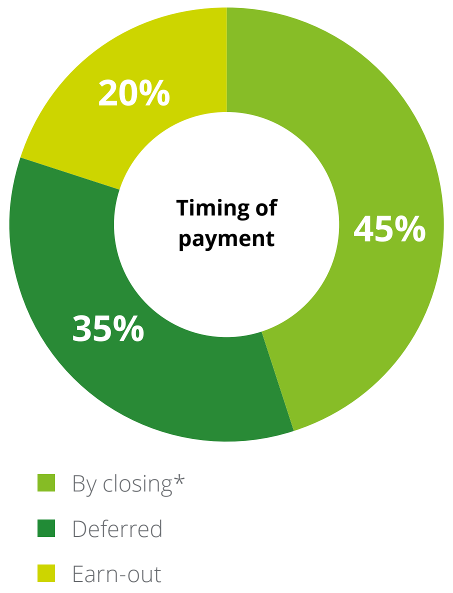
- Our study shows that about half of the deals were settled by the buyer at closing* while the other half included some element of deferred payment or earn-out. Although the closing date is the "intuitive" timing for purchase price payment, it may deprive the contracting parties of several benefits.
- A deferred payment element in the SPA postpones settlement of a part of the purchase price to an agreed date/dates post-closing (including consideration withheld in an escrow account). Our study shows that **35% of the deals** included some deferred payment element. Deferred payment may provide the buyer with a financial cushion for potential representations & warranties and indemnity claims (if set-off is allowed) or can simply help buyer's cash-flow management as a form of financing. Deferred payments are more common in closing accounts transactions (46% of closing accounts are deferred vs 14% in the case of locked box) to accommodate potential price adjustments.
- Another way to delay purchase price settlement is to introduce an earn-out element. It is effectively a contingent payment of a portion of the purchase price for the buyer.
- It also helps to address business volatility given either by the economic climate or the industry in which it operates.
- An earn-out is particularly useful in the case of negotiation deadlock as it helps to bridge the gap between seller's and buyer's price tag. In the post-COVID-19 climate, we may witness these gaps to widen as a result of increased buyers' skepticism or the increasing gap in valuation expectations of the parties involved. Introduction of an earn-out in the negotiations may make the difference between deal and no deal. Unfortunately, our experience shows that poorly structured earn-outs also lead to disputes.
- For the sellers, it is an effective motivation tool to realise upside and further value from the business especially if the sellers maintain their management roles in the target post-closing. In our sample, an earn-out element was agreed to in **20% of the deals**.
- We saw the vast majority of earn-out payments tied to a target's EBITDA to be generated in a 1 - 3 years period post-closing. Earn-out clauses were more common in the locked box mechanism vs closing accounts, serving as a protection against business volatility and addressing longer intervening periods before closing. Buyers should carefully consider the duration of earn-outs in light of their post-acquisition planning, as the earn-out may impede any early structural/ organisational changes.

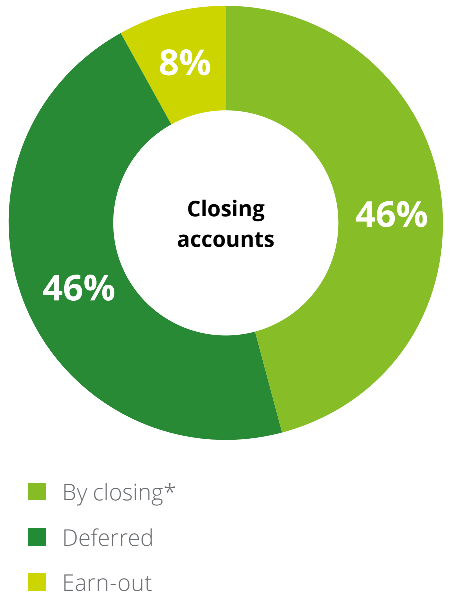
* including instances of "estimated vs final purchase price adjustment"

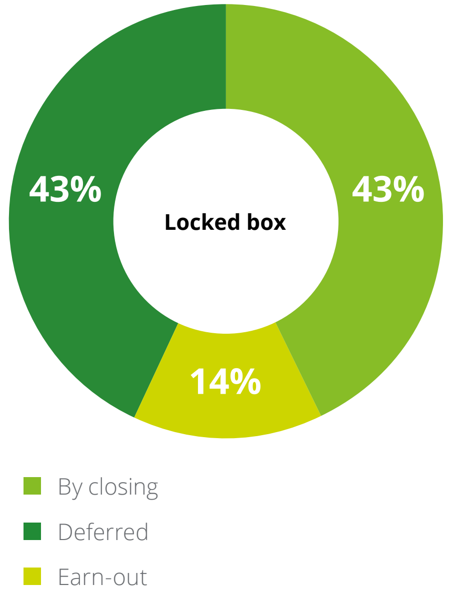




## Timing of payment & earn-out statistic



# Data room disclosure against the seller's representations & warranties, as the key instrument limiting the seller's liability, agreed in 94% of the deals.

## Representations & warranties: function

- Acquisition targets can have a long history of business operations and corporate affairs. Any risk associated with such business operations and corporate affairs negatively affects the value of the target.
- Representations & warranties allocate risk between the parties and serve as a foundation for a claim in the case of a breach or inaccuracy.
- Through representations & warranties, the sellers make certain representations about the target based on which the buyers are able to evaluate the target's business.
- If any of such representations & warranties end up to be untrue, incorrect or misleading, the buyer will usually have a claim under the SPA where such claim will effectively result in returning of a part of the purchase price by the seller.
- The representations & warranties are often subject to limitations. However, certain representations & warranties covering crucial areas such as incorporation, corporate existence, solvency, title to shares, title to material real estate and even tax liabilities (fundamental warranties) are customarily subject to a limitation-light regime as they are indispensable for a proper evaluation of the target.

## Representations & warranties: limitations

### Data room disclosure

- Sellers aim to limit their exposure to potential liability under the SPA, by providing representations & warranties to the extent information and documents have not been disclosed to the buyers in a data room or otherwise (data room).
- Such form of seller's liability limitation has been expressly agreed to in **94% of the deals** and is therefore **a key instrument** limiting the seller's liability under the representations & warranties.

### Monetary limitations

- There are three key thresholds limiting the seller's liability from a monetary perspective.
- First, a de minimis threshold limits potential individual claims resulting from a breach of the representations & warranties by setting a minimum amount below which any individual claim is excluded. This mechanism appeared in **90% of the deals**.
- Second, a basket threshold further limits potential claims resulting from a breach of the representations & warranties by setting a minimum aggregate (basket) amount of all individual claims below which all such individual claims are excluded. There are two types of basket thresholds, excess only and first dollar, where the former results in that the buyer may only claim amounts exceeding the basket threshold and the latter in that the buyer may claim all amounts once the basket threshold is reached. The excess only basket threshold remains less popular on the market as it had been agreed to only in **11% of the deals**, while the first dollar basket dominated in our study and appeared in **77% of the deals**. No basket threshold was set in **12% of the deals**.
- Third, a maximum liability cap limits the overall value of claims which the buyer may have with respect to the representations & warranties. Such mechanism appeared in **all of the deals.**

### Time limitations

- In **all of the deals**, the buyer's right to claim amounts arising from a breach of the representations & warranties was limited by the lapse of a certain time period starting from the closing of the deal.
- In **79% of the deals** the buyers needed to assert a claim within a certain agreed time period starting from the moment they have become aware of the circumstances giving rise to the claim.



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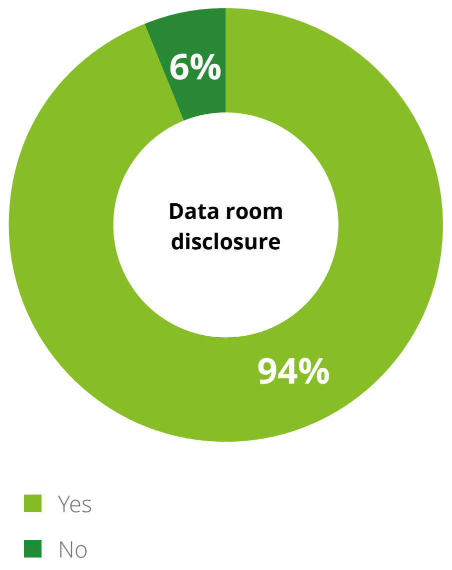
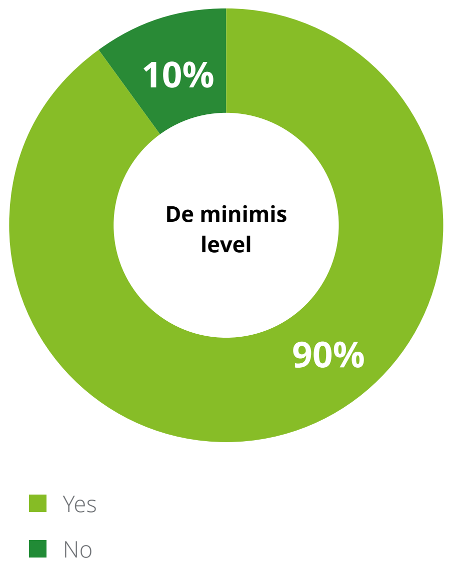
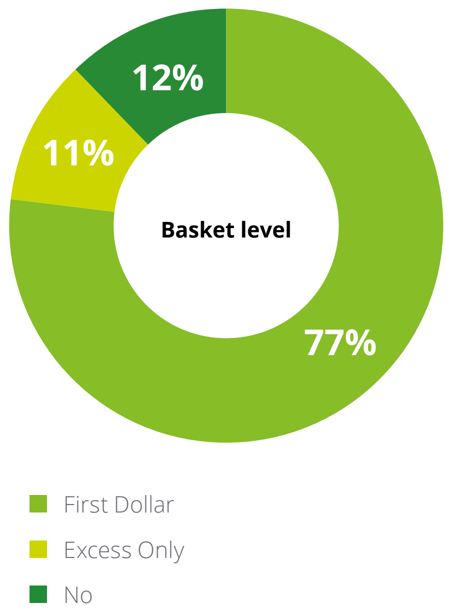


# Representations & warranties: Monetary and time limitations quantified.

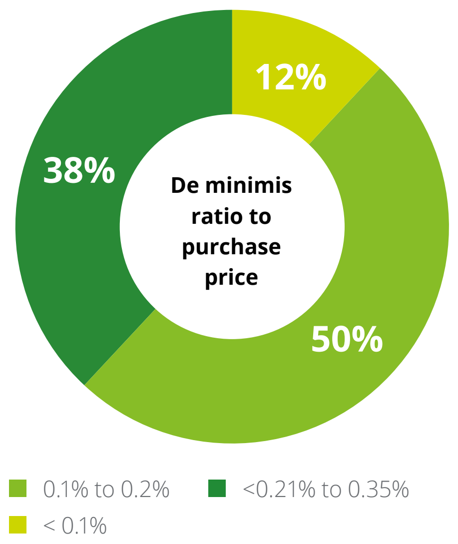
## Market standard revealed

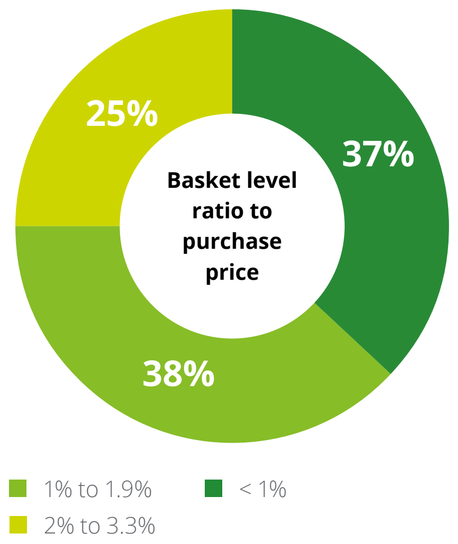
- De minimis thresholds generally do not exceed 0.35% of the purchase price
- Basket limitations generally do not exceed 3.3% of the purchase price
- The prevailing liability cap for breaching representations & warranties other than the fundamental warranties (general warranties) is 10% of the purchase price
- The maximum liability of the seller (including liability for breach of the fundamental warranties or indemnities) does not generally exceed the amount of the purchase price
- The sellers typically agree to repeat the representations & warranties at the closing date
- The time limitation for general warranties is generally up to 2 years, but for fundamental warranties it often exceeds 3 years
- The buyer is typically required to notify a warranty claim to the seller in 60 or less days from the time the buyer became aware of it

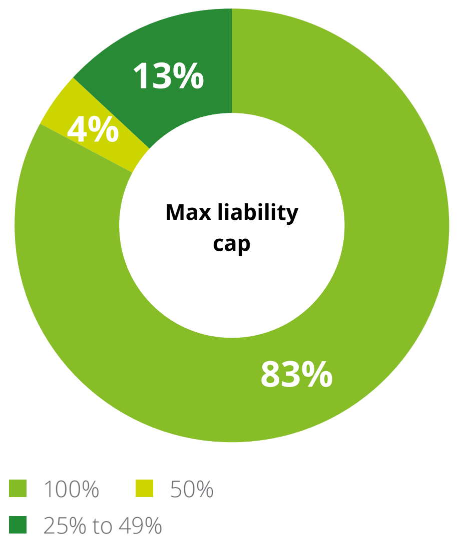


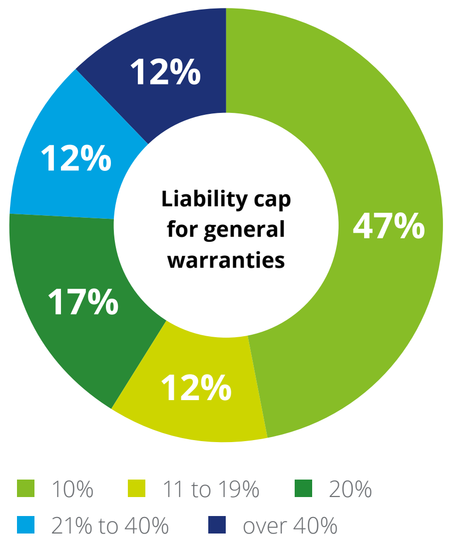


## Monetary limitations

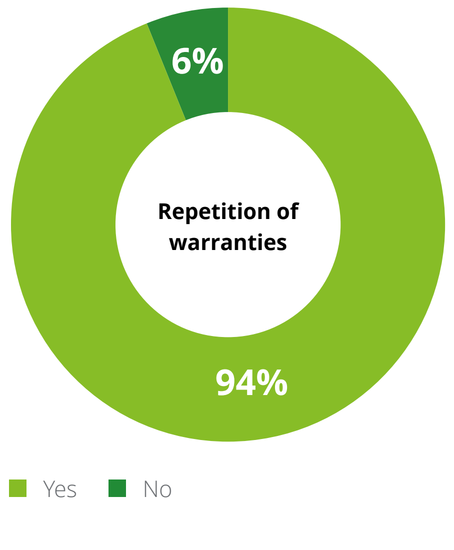


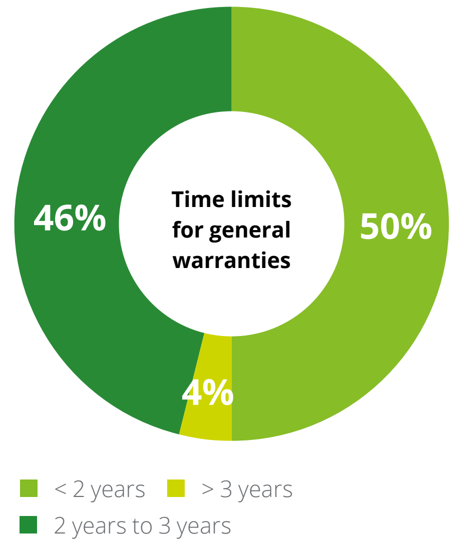



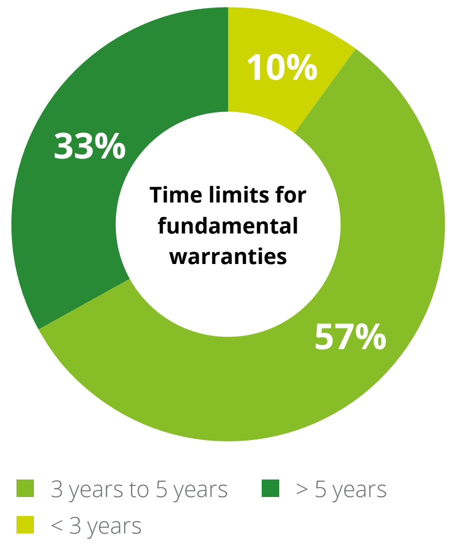



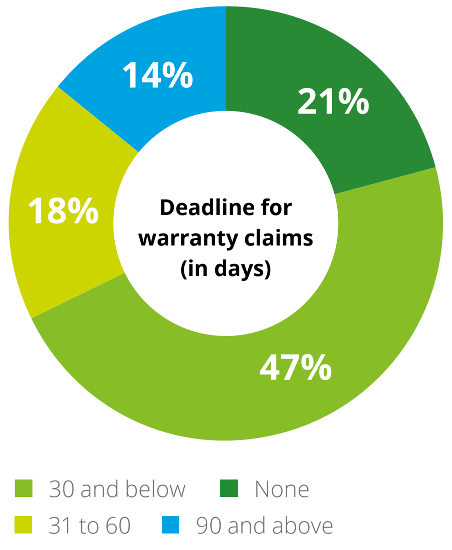




## Time limitations



# Indemnities are a frequent buyer's remedy accompanying representations & warranties and were negotiated and included in 73% of the deals.

## Relevance

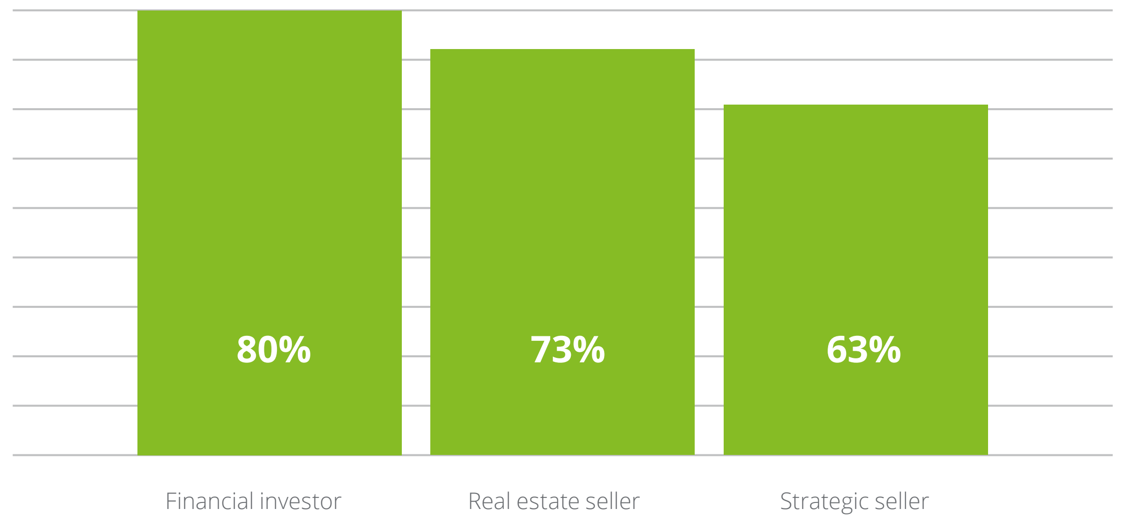
- Remedy for specific risks identified by the buyer
- Identified risks do not need to be reflected in the purchase price
- Only the actual losses suffered by the target are recovered (as opposed to expected or estimated losses being reflected in the purchase price)
- Applicable monetary and time limitations of the indemnities can be tailored to the specific risks identified by the buyer

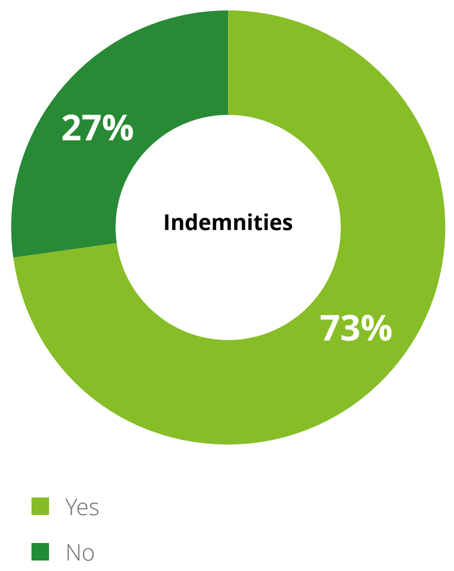
- Given the frequent use of the data room disclosure limitation, buyers need to reflect the risks identified within their review of the data room (due diligence) in the valuation of the target as they are not in the position to recover claims arising from such risks under the representations & warranties.
- As an alternative, buyers may seek indemnities for the identified risks in which case they do not need to reflect such risks in the valuation of the target, but can recover the relevant amounts from sellers if the risks materialise.
- Our study revealed that indemnities were negotiated and included in **73% of the deals** showing that in a majority of the deals substantial risks were identified within the data room review process where the parties agreed not to reflect them in the purchase price (valuation of the target).
- Simply put, when compared to representations & warranties, which protect the buyer against unknown risks, the indemnities serve to allocate known risks.
- It is generally easier to raise an indemnity claim compared to a warranty claim given that the risks covered by the indemnities are usually known as at the time the indemnity is provided, the legal basis of the claim is clearly stated in the SPA and the buyer may therefore refer to circumstances triggering the claim under the indemnities without a need to evidence a breach of representations & warranties.
- Specific monetary caps and time limitations may be applicable to indemnities but are highly dependent on characteristics of the individual risks.
- Our study shows that indemnities are most frequent in deals where there are financial investor sellers (**80% of the deals**) compared to strategic sellers (**63% of the deals**).





**Occurence of indemnities in deals by the seller type**



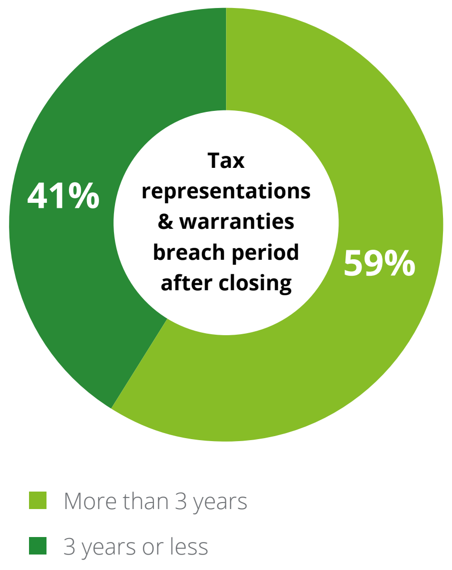
## Almost two thirds of tax representations & warranties were declared for a period longer than 3 years, the general statute of limitations for taxes in the Czech Republic.

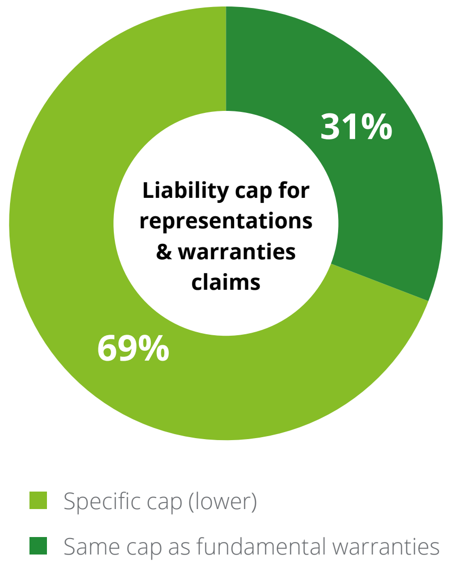
### Tax representations & warranties

- Serves as essential remedy for buyer with respect to tax risks
- Included in all of the deals in our study

- The seller's representations & warranties, including those related to tax matters, usually relate to the information that the buyer is relying on to value the company. For example, a seller represents that all tax returns of a target have been filed when due and tax liability has been paid timely and duly. If the representations & warranties were incomplete, incorrect or misleading, it might potentially keep a transaction from closing or trigger a legal dispute post-transaction.
- Any claims under tax representations & warranties are typically limited by specific monetary caps and time limitation periods.
- In one third of the deals, tax representations & warranties were of the same importance as other crucial representations & warranties (such as „title to shares"), jointly called fundamental warranties, and the respective claims were typically limited by 100% of the purchase price. In the remaining deals, tax representations & warranties were not equal to fundamental warranties which was reflected in lower monetary caps for tax representations & warranties claims.
- With respect to time limitation periods, we saw in our study that almost two thirds of tax representations & warranties were declared for a period longer than 3 years, i.e., longer than the general statute of limitations for taxes in the Czech Republic. The length of tax representations & warranties time limitation was more or less irrespective of the type of a buyer (financial investor, real estate or strategic investor), while strategic and real estate sellers were willing to provide longer tax representations & warranties time limitations compared to financial investor sellers.
- In order to get the best SPA protection, the buyer will seek the time limitation of tax representations & warranties corresponding at least to the maximum statute of limitations of the target's taxable periods ending before the closing, while it is in the seller's interest to minimize such time limitation where possible.





# A tax indemnity was agreed in 42% of the deals, of which about one third were in the form of a full tax indemnity, while the remainder represented specific tax indemnities.

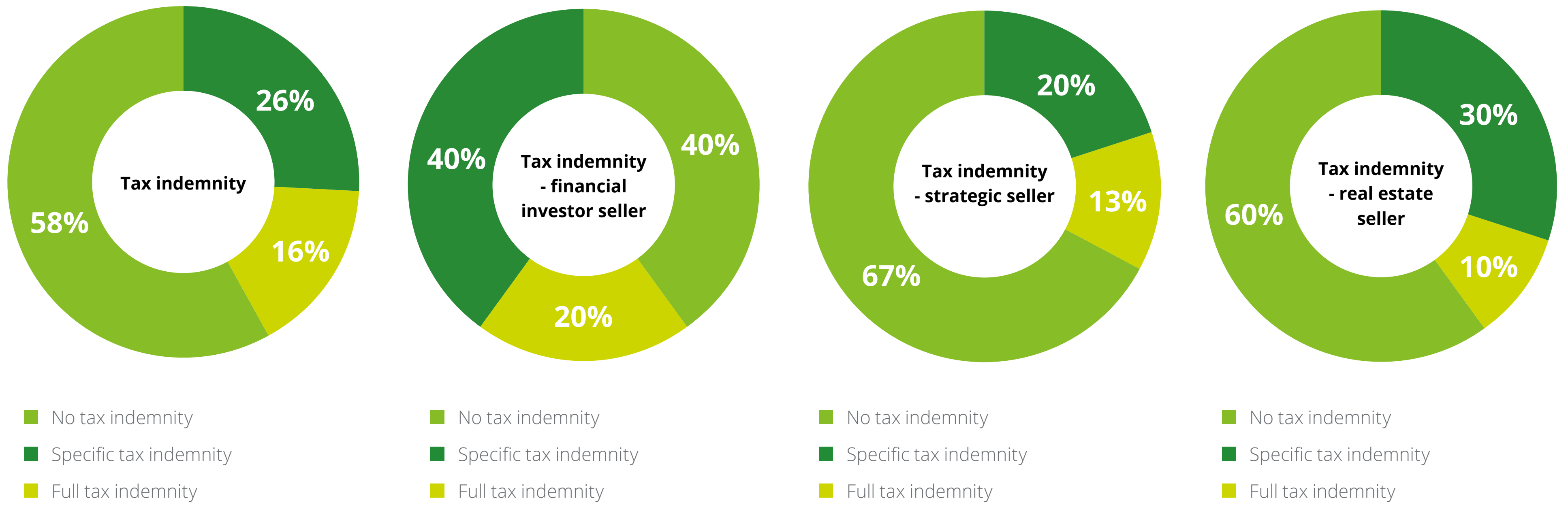
## Tax indemnity

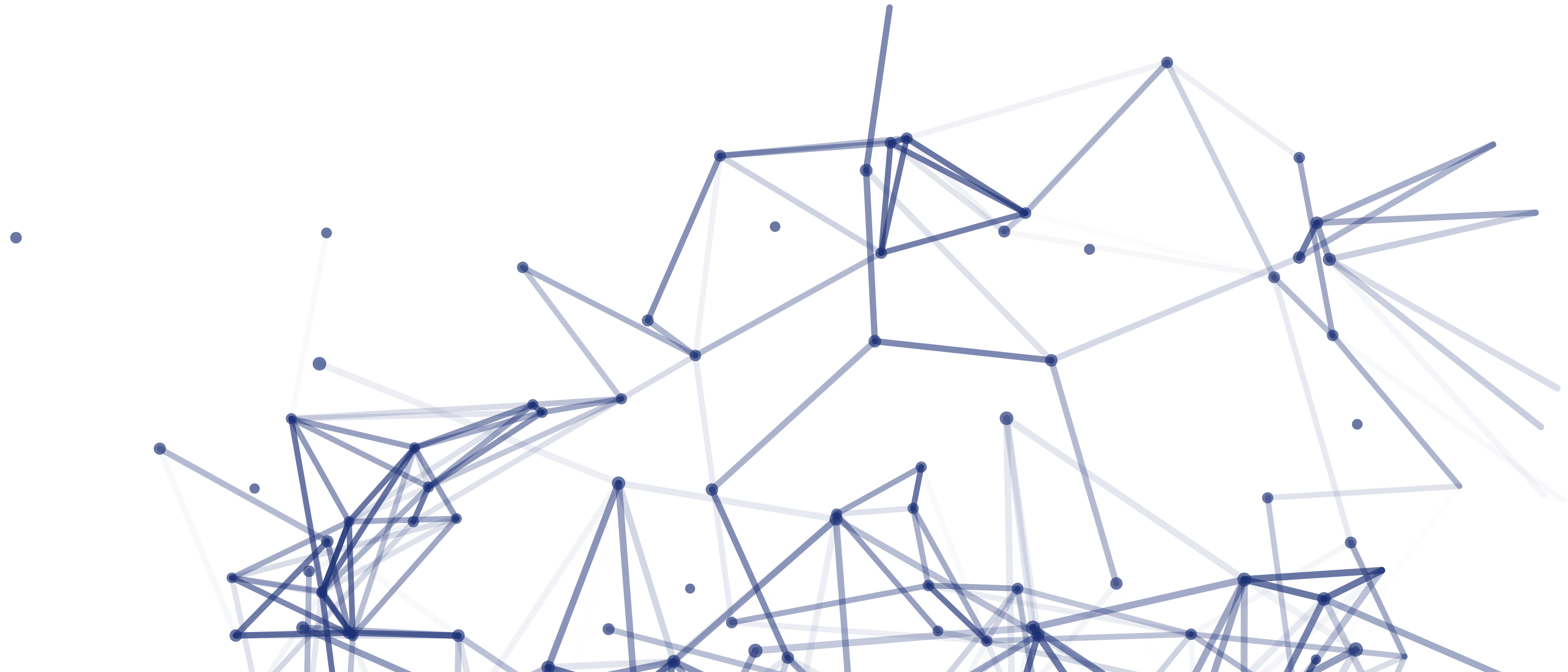
- Serves as a remedy for high tax risk areas which have been identified by the buyer
- Identified risks do not need to be reflected into the purchase price
- Usually enables higher damage compensation for the buyer compared to representations & warranties protection

- It is customary in M&A deals that buyers attend closely to tax-related risks. Apart from representations & warranties, buyers often seek an indemnity for any identified pre-closing tax risks. Buyers may even request that the sellers provide a full tax indemnity for any pre-closing tax liabilities, including tax liabilities unidentified by the buyers, despite the sellers having disclosed all tax matters and buyers having conducted a tax due diligence.
- A tax indemnity was agreed in **42% of the deals** in our study, of which about one third were in the form of full tax indemnity, while the remainder represented specific tax indemnity (for particular tax risks, e.g., tax deductibility of management fees, transfer pricing, etc.). The limited distribution of general tax indemnity in our study shows the unwillingness of the sellers to grant such a wide remedy to buyers. But if granted anyway, it is usually when the buyer is unable to gain sufficient comfort in major tax areas.
- Our study also suggests that a tax indemnity was agreed to more often in cases when the selling party was a financial investor seller (**60% of the deals**) or real estate seller (**40% of the deals**), compared to a strategic seller (**33% of the deals**).
- Similarly to tax representations & warranties, tax indemnities usually include specific monetary caps and time limitation periods. The monetary caps are very often determined by a precise calculation of tax risks in the case of specific tax indemnities or a commercially agreed fixed amount/percentage of the purchase price. The time limitations periods were never set shorter than 3 years, i.e., the general statute of limitations for taxes in the Czech Republic.
- Given the high risk potential of tax issues being subject to a tax indemnity, we saw that in **15% of the deals** deferred payment schemes (e.g., escrow or hold-back arrangements) were used as a financial cushion for the potential breach of tax indemnities.







# About one third of the deals miss a gross-up clause leading to a risk of an additional tax burden for the parties to the SPA if withholding or deduction by operations of (tax) law materialise.

## Benefits

- A gross-up clause is important for both parties to the SPA in order to avoid additional tax burden
- Cooperation clauses give sellers the space to actively manage third party claims of buyers

## Gross-up clause

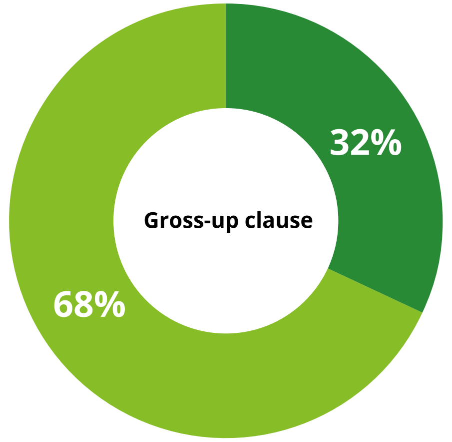
- In general, a gross-up clause provides that all payments (purchase price, purchase price adjustments, damage compensations, etc.) under the SPA must be made in the full amount, free of any deductions without exercising any right of set-off. The provision will also indicate that in case of a mandatory withholding or deduction by operation of (tax) law, the paying party shall „gross-up" the payment so that the receiving party receives the same net amount, as if no withholding or deduction had ever happened.
- Missing or poorly drafted gross-up clause leads to additional tax burden (e.g., withholding taxes, tax securement, VAT, etc.) for sellers when receiving a purchase price or for buyers when receiving a damage compensation under the SPA; the accounting treatment (balance sheet vs P&L impact) plays a significant role in the tax consequences. Properly drafted gross-up clause is particularly important when carve-outs of assets (which are often subject to taxes) are part of the transaction perimeter and the SPA.
- Our study shows that a gross-up clause was included in **68% of the deals**. This percentage was significantly higher in the case of the deals with financial investor buyers.

## Cooperation clause

- Cooperation clauses enable a seller's involvement in managing third party claims (e.g., those raised by the tax authorities with respect to a tax audit) initiated by a buyer after the closing. Further, this clause might be used to set up a modus operandi of the seller and buyer in terms of assuring the tax compliance before and after the closing (often in case of a locked box mechanism).
- A general form of cooperation of the sellers in managing third party claims in the tax area was agreed in almost all the deals. However, we observed in our study that there is no market standard for such cooperation and it could range from minimal involvement of the sellers in third party claims to a full take-over of third party claims by the seller with many variations in between.
- In one third of the deals, the parties agreed on rules of cooperation in tax compliance (preparation and filling of tax returns, mostly VAT) related to the periods to which the closing date falls in.








Included in the SPA
Not included in the SPA


No
Yes

# Stable demand for warranty & indemnity insurance.

## Benefits of warranty & indemnity insurance

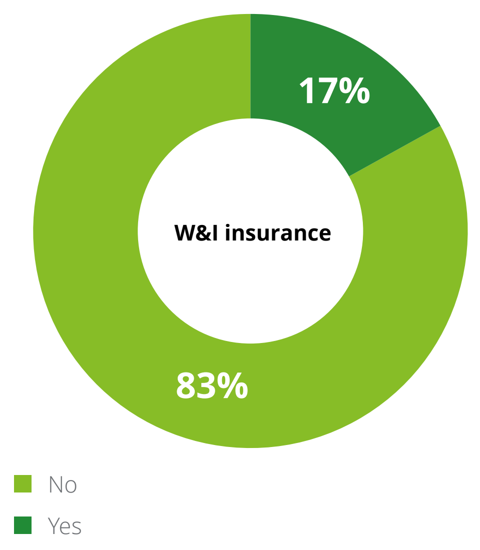
- Allocates a number of risks arising under the deal to the insurer
- Limits the seller's liability post-closing and therefore allows for a clear-cut separation of the seller from the target
- Mitigates concerns over the seller's financial position and capability to cover potential warranty & indemnity claims
- Is generally welcomed by financing banks and may therefore expedite acquisition financing
- May facilitate the negotiations if the parties have a hard time agreeing on allocation of risks
- Positions bidders well in auctions as they may accept a lower standard of representations & warranties and/or indemnities

## Warranty & indemnity insurance

- Warranty & indemnity insurance is a useful instrument if the parties wish to allocate uncertain risks of the transaction to a third party and make the risks easily quantifiable via the insurance premium.
- Based on our study, warranty & indemnity insurance was arranged in **17% of the deals**.
- Despite a number of benefits connected to warranty & indemnity insurance, its appearance in the local deals remains below 20% which is to our knowledge comparable to the surrounding jurisdictions.
- This is presumably caused by warranty & indemnity insurance potentially (i) increasing the transaction costs, (ii) delaying the closing of the deal as insurers often conduct additional due diligence of the target, (iii) requiring an additional set of documents to be negotiated, and (iv) increasing confidentiality concerns.
- The parties need to pay close attention to the exclusions under the insurance terms (i.e., certain items being excluded from coverage under the insurance terms).
- In the light of the COVID-19 outbreak, COVID-19 exclusions have become popular on the insurance market and their scope needs to be closely analysed in each individual deal.







# The deal is not set in stone until closed: termination and rescission rights likely to become key COVID-19 related factors.

## Termination rights

- Some form of termination right allowing the buyer to walk-off from the deal in the period between the signing and closing date was available in **62% of the deals**.
- While sellers will typically seek to limit or fully exclude any such buy-side rights, buyers will on the other hand aim for the broadest extent of such rights possible.
- The main events triggering the buyer's walk-off right are material adverse change (MAC) affecting the target (**38% of the deals**), followed by breach of representations & warranties (**28% of the deals**) and breach of interim covenants (**22% of the deals**), where in some of the deals multiple walk-off rights were available to the buyers.

## MAC clause

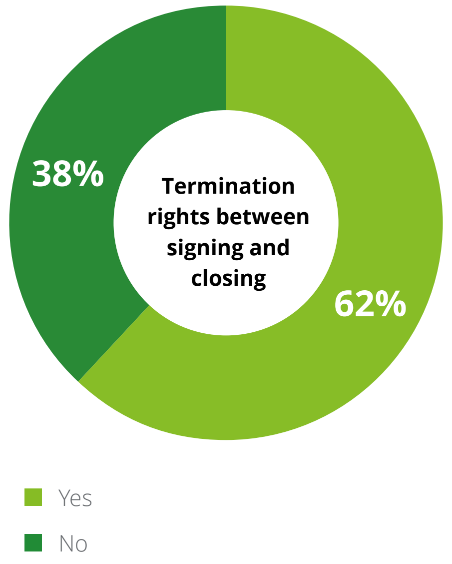
- The MAC clause allows the buyer to walk-off from the deal if a defined adverse event or events of a material impact on the target occur (for example, the material impact may be defined as a specific amount by which the value of the target decreases).
- The traditional objection against the MAC clause is that its definition in the SPA is generally broad and allows for multiple interpretations.
- However, buyers managed to implement a MAC clause into the SPAs in **38% of the deals**.
- We have seen and expect to keep seeing an increased push of buyers for MAC and similar provisions (e.g., force majeure provisions) to be included into the SPAs as a result of the COVID-19 outbreak. In an environment where national governments adopt unprecedented measures which are difficult to predict, buyers naturally resist accepting the risk that they will be required to pay for what becomes an overpriced business at closing.

## Low popularity of break-up fees

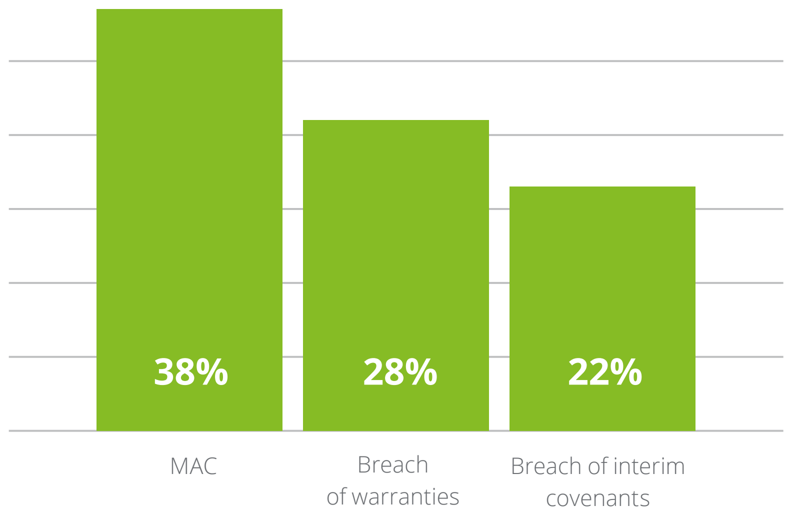
- The current trend suggests that there are no break up fee provisions in the vast majority of SPAs.
- Some form of break-up fee was agreed in **19% of the deals**.
- In approximately **10% of the deals** the break-up fee was specified as a fixed lump sum.
- In approximately **9% of the deals** the break-up fee was tied to reimbursement of the actual costs related to the deal termination.

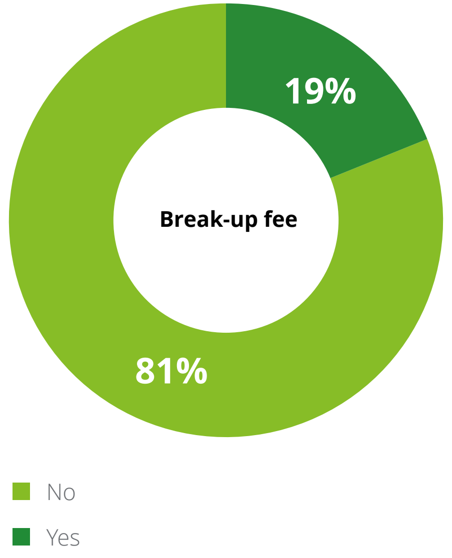







Termination rights between signing and closing



## How to solve a dispute? Under local law, but in international arbitration

| State courts | Arbitration |
|---|---|
| Judge assigned by the operation of law | Choice of the arbitrator(s) by the parties |
| Slower on average | Faster on average |
| A number of remedies against the court's decision | Limited remedies against the decision of the arbitrators |
| Generally less expensive than international arbitration | International arbitration (VIAC, ICC etc.) generally more expensive |
| Proceedings strictly prescribed by law | Generally more flexible proceedings |
| Enforceability of the final decision generally lower outside the EU | High enforceability in most of the world under the New York Arbitration Convention |
| State courts operate in their local language (may result in high costs of translations) | Choice of the language of the arbitration |
| Public proceedings (in principle) | Confidential proceedings (in principle) |

### Arbitration as a local phenomena

- Choosing between state courts and arbitration is a traditional issue in the SPAs.
- In the Czech Republic, arbitration is more popular than state courts, with the parties choosing arbitration in **59% of the deals** as compared to **41%** where they chose state courts.
- The key conditions are (i) choice of the arbitrators and their specialisation, (ii) generally faster proceedings, (iii) flexibility of the proceedings and language used, (iv) confidentiality of the proceedings, and (v) the effect of choosing a neutral venue if the seller and purchaser are based in different jurisdictions.
- The most popular arbitration courts were Vienna International Arbitral Centre (VIAC) (**24% of the deals**), followed by ICC International Court of Arbitration (ICC) (**17% of the deals**).

### Dominance of local law

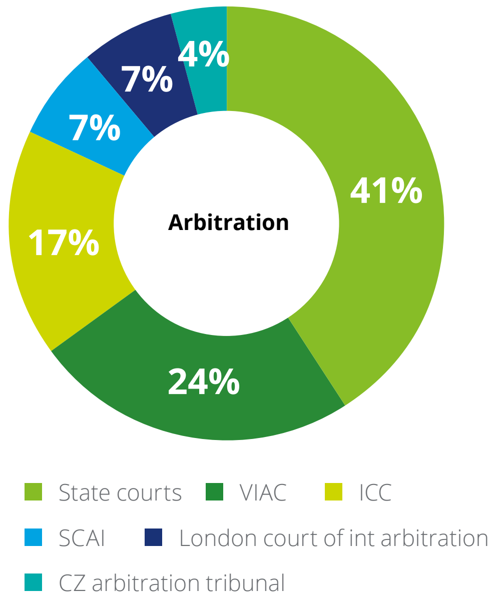
- Most of the SPAs within our study were governed by Czech law (**85% of the deals**).
- Where the parties chose foreign law, English law was their number one choice.
- There is a strong correlation between the choice of foreign law as governing law and the choice of arbitration.

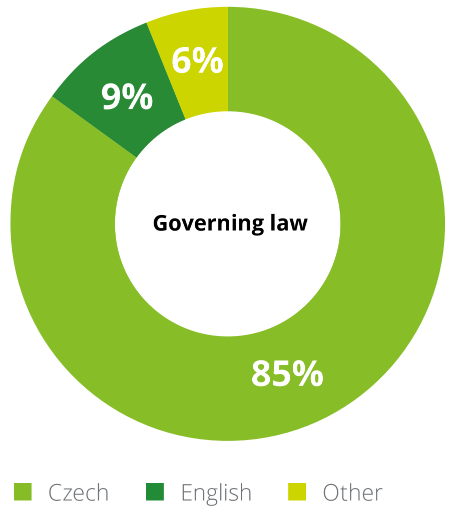
### Potential COVID-19 impact

- The implications of the COVID-19 outbreak may affect both the choices of court venue and governing law.
- Parties may favour state courts or local arbitration to save costs as international arbitration is generally more expensive.
- State courts to be potentially involved in distressed deals mandatorily.







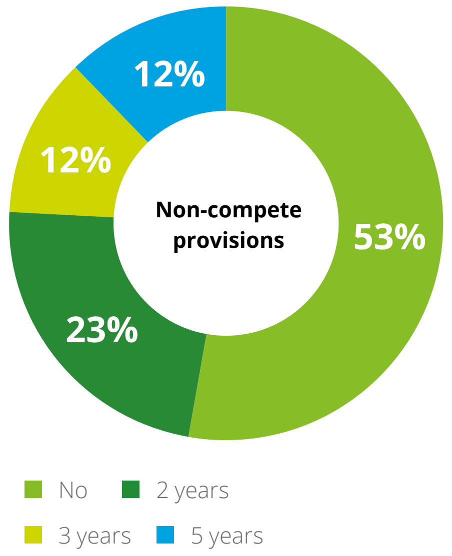
# Non-compete provisions in about half of the deals.

## Non-compete provisions

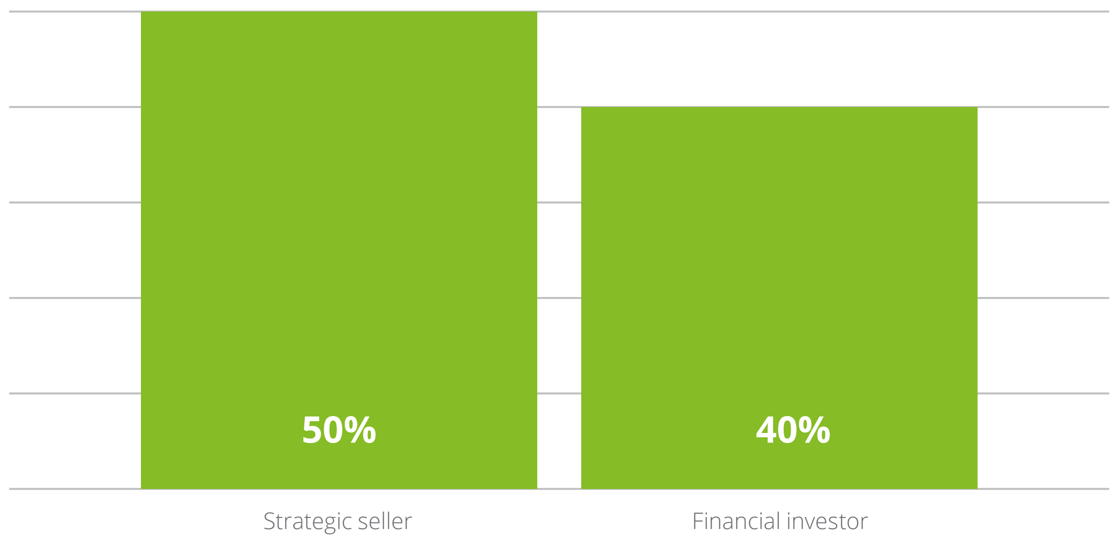
- As a key instrument to protect the buyer's investment against the seller's activities in the target's business, non-compete provisions were agreed in about half of the deals.
- The buyer needs to carefully review the wording of the non-compete provision in order to ensure that the seller is sufficiently restricted from business activities of a competitive nature to the business activities of the target. In particular, the buyer should assess whether the restricted business activities are properly defined by listing the relevant product markets and whether the non-compete provision covers the whole territory of the target's core business.
- Non-compete provisions in length of 2 and 3 years were included in **23% and 12% of the deals**, respectively.
- **12% of the deals** included a non-compete provision of 5 years, however, any non-compete obligation exceeding 3 years needs to be carefully considered given the applicable anti- trust regulations.
- Our study shows that non-compete provisions are most frequent in deals where there are strategic sellers (**50% of the deals**) compared to financial investor sellers (**40% of the deals**).








**Occurence of non-compete provisions by the seller type**



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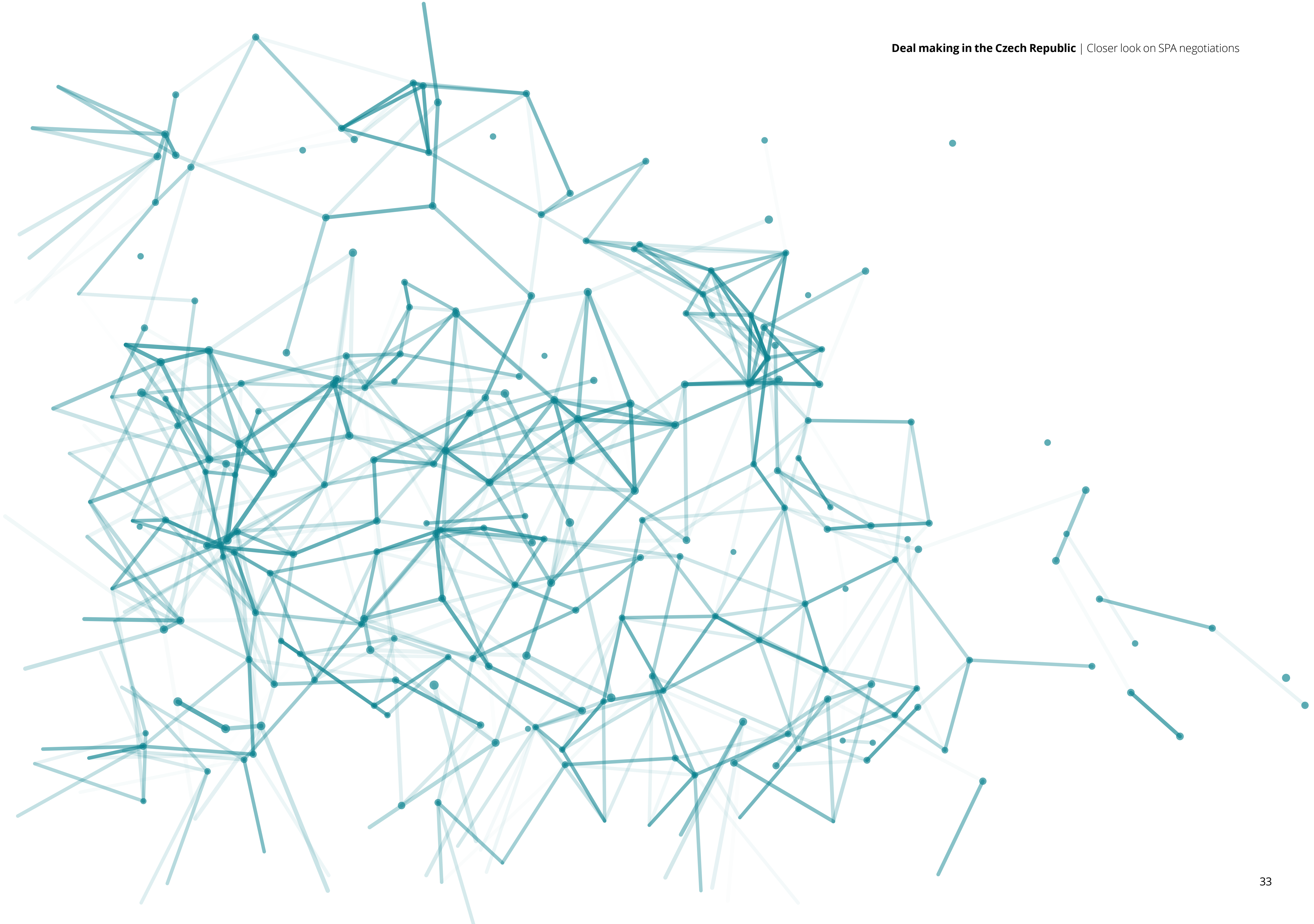

Deloitte.

In this study, we have gathered information from M&A deals on which Deloitte has advised in recent years. In the selection of deals, we limited ourselves to acquisitions/disposals of targets located in the Czech Republic in order to provide a unique insight into the local M&A landscape. We have excluded intra--group and similar deals which might not reflect the results of negotiations of independent parties. Additionally, due to a specific nature of the sector locked box, closing accounts, timing of payments, and non-compete provisions statistics exclude transactions in real estate sector. When gathering the information, we have relied on final drafts and, where not available, on advanced drafts of the relevant SPA.

In order to compile this study, we needed to generalise certain legal, financial and tax elements of the available draft SPA. Although such generalization is possible to certain degree, each of the deals had its specific features which cannot be fully reflected in this study. The figures and percentages in this study have been rounded. As a result, there may be rounding differences within and between charts.

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