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Legal

Dealmaking in Central Europe

A closer look at Share Purchase Agreements

February 2022

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Foreword

The sale and purchase agreement in M&A transactions represents the very peak of the entire transaction process.

This process can often last many months from the initial phase, through to the buyer due diligence, and up until the negotiation, signing, and closing of the sale and purchase agreement itself.

The sale and purchase agreement thus reflects a number of inputs originating from the entire transaction process. This includes the allocation of the economic benefits and risks associated with the target company or group between the seller and the buyer.

Since the dawn of modern M&A transaction history in Central and Eastern Europe in the early 1990s, this market, like that of continental Western Europe decades before, has adopted the contractual standards developed in the Anglo-American M&A transactional world, albeit with variations modified to the continental codified legal system. Therefore, many traditionally Anglo-American concepts used in M&A sale and purchase agreements are, seen from the angle of their purpose, also applied to transactions in Central and Eastern Europe.

The Deloitte Legal network comprises over **2,500** legal professionals in more than **80** jurisdictions. In Central Europe, Deloitte Legal spans **25** offices in **16** jurisdictions with more than **380** legal professionals. This position allows us to collect enough data to prepare this study, which covers the terms and conditions of **140** M&A transactions that our Central European practice has been involved with from 2019 up to mid-2021.

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16

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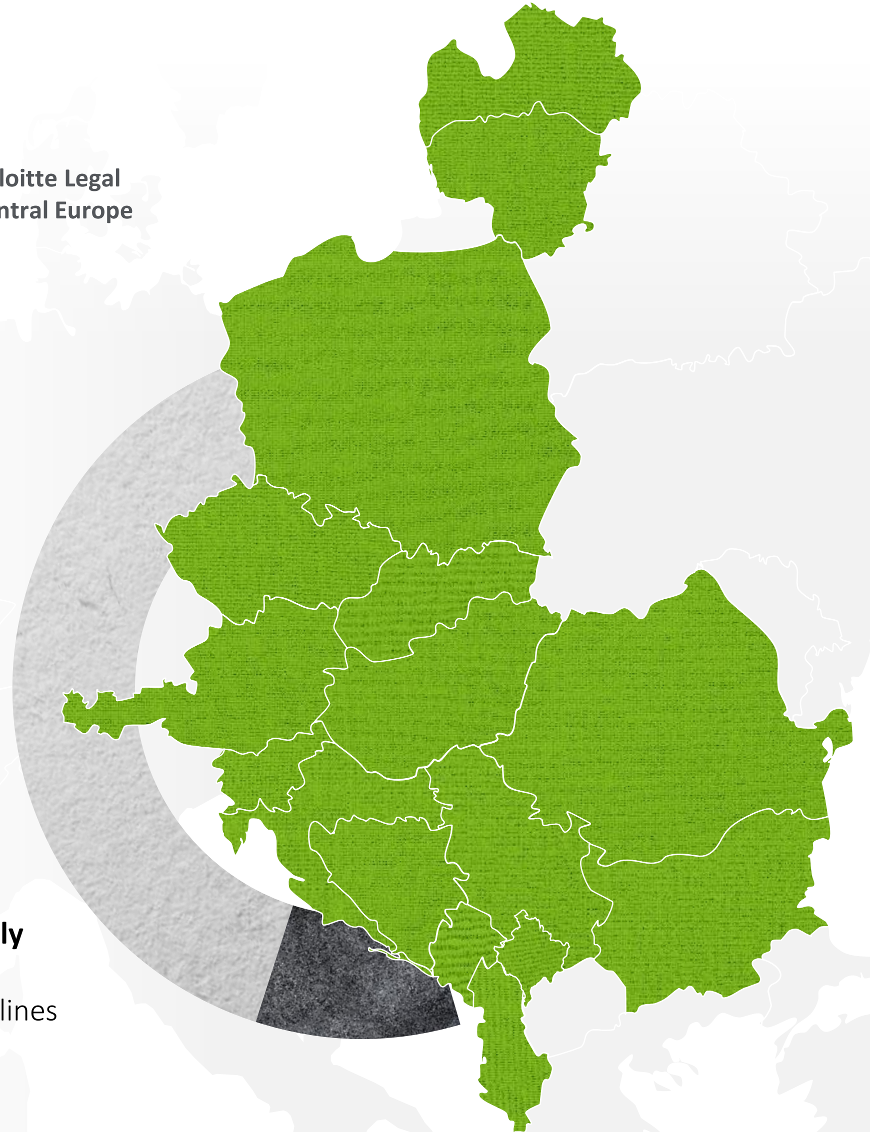

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Foreword

> We can see more frequent pressure on mechanisms to reflect target company development after the buyer due diligence, or transaction closing, for a more accurate purchase price.

One of these trends is a certain return to the "closing accounts" mechanism in the purchase price at the expense of the so-called "locked-box" mechanism, whose popularity before the pandemic has been growing.

It will certainly be interesting to follow the further development of the M&A transaction environment in Central Europe. Our team would like to follow up this study with an update some time in the near future to reflect the post-pandemic environment. The market standard conditions of M&A transactions in coming years will certainly be affected by other social and economic challenges.

The pressure to reduce the carbon footprint of companies and other areas of environmental, social, and corporate governance responsibility will have an impact. We believe that further updates of this publication will be of interest to the business community.

Finally, I would like to thank the more than twenty-member editorial team of lawyers and business professionals from all sixteen Central European countries that participated in this study for their wonderful cooperation. I believe that the results of their contributions will be an interesting addition to the M&A expert community.

Petr Suchý

Partner, M&A Expertise Group Leader

Deloitte Legal Central Europe

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Purchase price mechanism

Closing accounts versus locked box

Across the Central European region, closing accounts are the most popular purchase price mechanism for M&A transactions, which is then followed by locked box and other/hybrid mechanisms. When taking a closer look at this we can see that the preference for a certain purchase price mechanism varies significantly between the individual countries in the region.

Closing accounts

As a traditional and popular concept in M&A transactions, purchase prices are adjusted post-closing based on any differences between the target or estimated financial parameters (usually net debt, working capital and sometimes capex) and the details determined based on closing accounts (sometimes called “completion accounts”) as special purpose transaction accounts. Such accounts are typically subject to a mechanism involving independent experts to finally (and without recourse) resolve potential disputes regarding the closing accounts.

Purchase price adjustments serve as a kind of “true up” of the value of the target and protects the buyer from the value erosion of the target until the closing date. At the same time, this allows the seller to enjoy the economic benefit of the business until the closing.

Our study shows that closing accounts are the preferred purchase price mechanism in M&A transactions in the Central European region and are used in **44%** of the deals. Although the study indicates a tendency towards parties opting for the closing accounts mechanism, a closer look reveals that the preference for a certain purchase price mechanism varies significantly in the individual countries in the region. While closing accounts are the preferred purchase price mechanism in Albania, Bosnia and Herzegovina, Czech Republic, Kosovo, and Romania; locked box is preferred in Austria, Croatia, Lithuania, and Serbia. In Bulgaria, Hungary, Latvia, and Slovakia, purchase price mechanisms other than closing accounts or locked box, or hybrid versions thereof, are the mechanisms of choice. Poland and Slovenia, on the other hand, show an equal distribution of locked box and closing accounts mechanisms in the deals reviewed.

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Purchase price mechanism

Closing accounts are often used in cases when the buyer's confidence in the financial statements or accounting policies and systems of the target might be weaker. They are also used in the case of long periods between the last balance sheet date and closing (without robust interim financials being available and warranted). Further, buyers tend to prefer closing accounts if they expect a decline in the target's business, e.g., due to seasonality, volatility, or market distortions caused by external events such as the ongoing COVID-19 pandemic.

Benefits of closing accounts:

- The economic risk and reward is transferred at closing.
- The "True up" of the target valuation is based on a post-closing purchase price adjustment.

Downsides of closing accounts:

- Reduced price security given the post-closing adjustment.
- Increased complexity and less time- and cost-efficient as additional special purpose accounts are required.
- Risk of disputes regarding the closing accounts or of de facto renegotiation of the purchase price.

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Purchase price mechanism

Locked box

This is a popular purchase price 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.

Locked box mechanisms typically include strict pre-completion covenants and indemnities of the seller protecting the buyer against any leakage of value to the seller (and its affiliates) in the period between the last balance sheet date and the date of closing and ensuring an ordinary course of business until closing. Further, buyers may be required to pay interest on the purchase price since the date of the locked box accounts.

While the locked box provides price certainty to the parties, buyers are likely to conduct more extensive due diligence, and to request more comprehensive seller's warranties, to address the risks of a deterioration of the business between the locked box date and closing.

The study shows that locked box is the preferred purchase price concept in Austria, Croatia, Lithuania, and Serbia, and is equally used in Poland and Slovenia as compared to closing accounts.

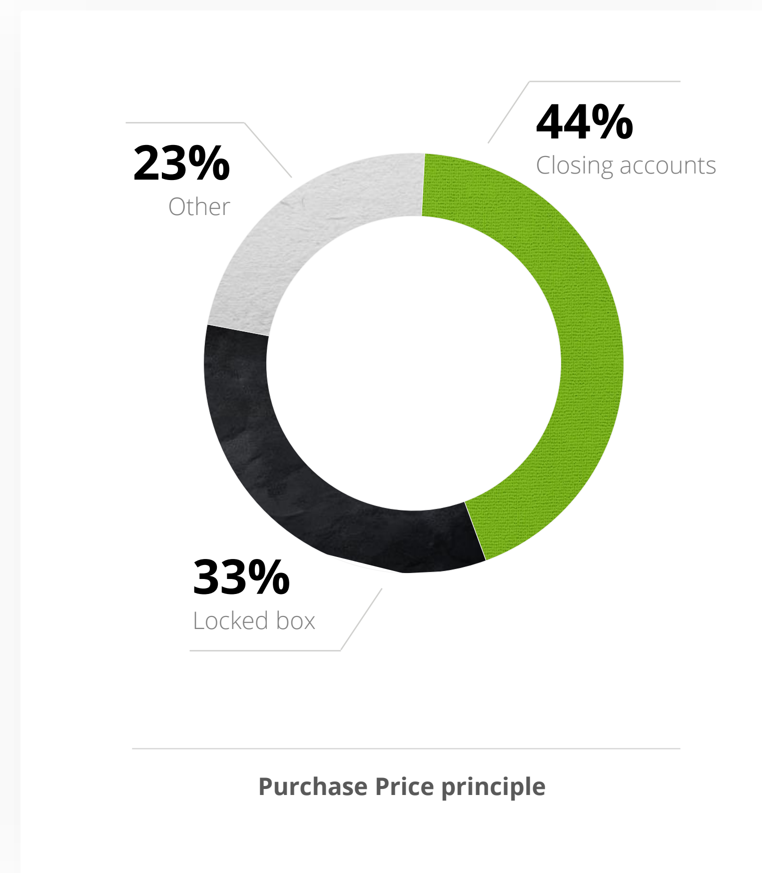
Locked box is favoured by sellers and tends to be accepted more likely by buyers if recent (audited) accounts are available and the time between the locked box and closing is minimized, thus, reducing the risk of value loss since the locked box date.

Benefits of locked box:

- Simplicity as well as the time and cost efficiency of the mechanism as there is no need for additional special purpose accounts.
- Purchase price certainty and less risk of purchase price disputes or de facto renegotiations at closing.

Downsides of locked box:

- Economic risk and reward transferred as of the locked box date and no "true up" of target value.
- Reliance on historical accounts.
- Discussions on no-leakage undertakings, other pre-completion covenants and more comprehensive seller's warranties.



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Purchase price security

Hold-back / Earn-out / Escrow

Our study shows that **70%** of the deals were settled by the buyer at closing while the remaining **30%** included some element of deferred payment or earn-out.

A deferred payment element in an SPA postpones settlement of a part of the purchase price to an agreed date, or dates, post-closing (including consideration withheld in an escrow account).

In the COVID-19 climate, we witnessed a broader use of deferred payment schemes (e.g., escrow or hold-back arrangements) as a financial cushion.

- The hold-back mechanism was used in **30%** of the deals.
- Escrow account was used in **29%** of the deals.

Another way to delay purchase price settlement is to introduce an earn-out element. Our study shows that this mechanism was used in **14%** of the deals.

An earn-out element represents a contingent payment of a portion of the purchase price for the buyer, which we witnessed especially in the COVID-19 climate as well. It is useful in the case of a negotiation deadlock and helps to bridge the gap between the seller's and buyer's price tag.

It is also an effective motivation tool for the seller to realize the potential future value from the business, especially if the seller retains their management board roles in the target post-closing.

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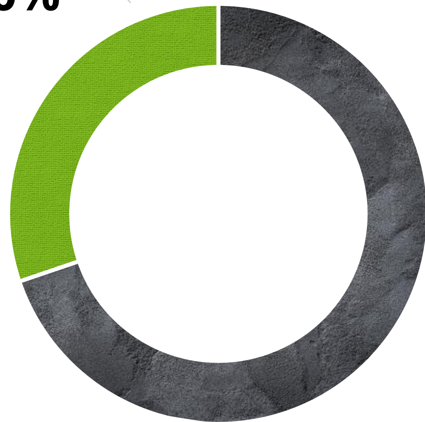
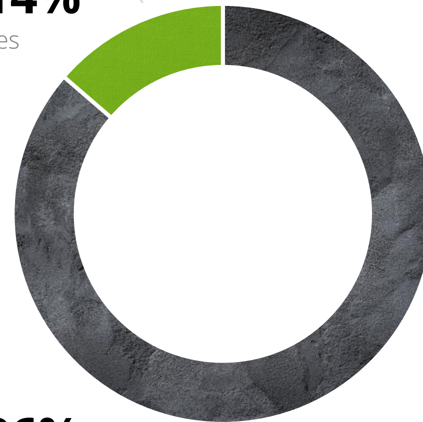
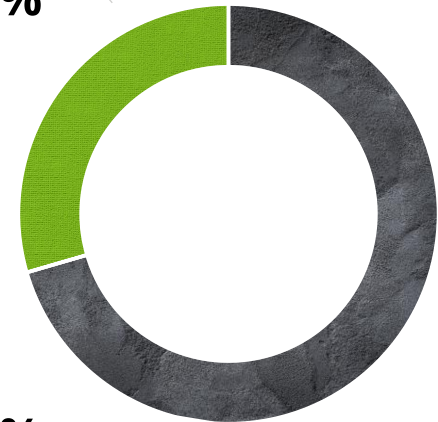
Purchase price security



Hold-back



Earn-out



Escrow

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Representations & Warranties (R&W)

Function

Acquisition targets can have a long history of business operations and corporate affairs. Any risk associated with business operations and corporate affairs of the companies can negatively affect their value.

Representations and warranties are statement of facts made by the seller to the buyer as of a particular point of time. They reveal facts important for the buyer in order to evaluate the target's business and to make the decision to enter into the respective transaction.

The other function of the representations & warranties is to allocate the risk between the parties under the SPA and serve as a foundation for a claim. In the case of a breach or inaccuracy of the statements of the seller, the buyer as a recipient is entitled to remedy (the claim could effectively result in returning part of the purchase price by the seller).

The representations & warranties are often subject to repetition and/or limitations.

Repetition at closing

Usually there is a time gap between the signing and closing of the transaction, hence the necessity for the inclusion of certain representations & warranties at the time of the closing of the deal. The representations & warranties made at the signing of the SPA are commonly "brought down" at closing. The statistics from the examined SPAs confirm this trend, whereby **76%** of the samples repeat certain representations & warranties upon closing.

Knowledge Qualifier

The knowledge qualifier (the limitations resting upon the presumption that the seller is exempt from liability due to the lack of knowledge of a certain circumstance) is commonly used in the SPA in order to limit the responsibility of the seller, should a future liability occur. Such a clause undermines the predictability and certainty of the buyer. The usage of this limitation clause is widely spread within the region and our study reveals that **60%** of the sample SPAs contain such a clause.

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Representations & Warranties (R&W)

Disclosure Limitations

Sellers aim to limit their exposure to potential liability under the SPA, by providing representations & warranties to the extent that information and documents have not been disclosed to the buyers in a data room or otherwise.

Disclosure Letter

The use of a Disclosure Letter is not an extensively spread approach to widen limiting the liability of the seller since our study reveals that only **36%** of the sample SPAs have relied on that type of liability restriction clause. The purpose of disclosing certain information in respect of the target in a Disclosure Letter is clearly a tool for obstructing potential liability. The rationale behind it is that once the seller duly informs the buyer of any existing prerequisite that may impose a negative impact in the future, it then upholds the burden of any future claims arising out of the disclosed details. We noted contrasting positions when comparing the different SPAs presented in various countries. **Nine out of 16** countries which participated in the study reveal that the Disclosure letter is not used as a liability limitation tool in the completed SPAs. Only **20%** of the SPAs in Austria and Hungary encompass such clauses.

Data Room Disclosure

The commonly accepted practice to disclose information via the use of a data room created an additional opportunity for sellers to invoke a limitation under the representation & warranties. In essence, once a document is placed in the data room, it constitutes a disclosure, and the seller is exempt from any further burden. Data room disclosure against the seller's representations & warranties, as the key instrument limiting the seller's liability, is agreed in **63%** of the deals.

Public Registers Disclosure

The clauses referring to information, which is available to the broad public and can be accessed through Public Registers, is not a commonly spread tool to limit the seller's liability under the representations & warranties clauses. The study reveals that **69%** of the SPA samples do not rely on this method for limitation and do not allocate the risk towards the buyer. The outliner in the study is Croatia reflecting that **75%** of the signed SPA do contain a representations & warranties limitation clause in respect of the information listed in the Public Registers.

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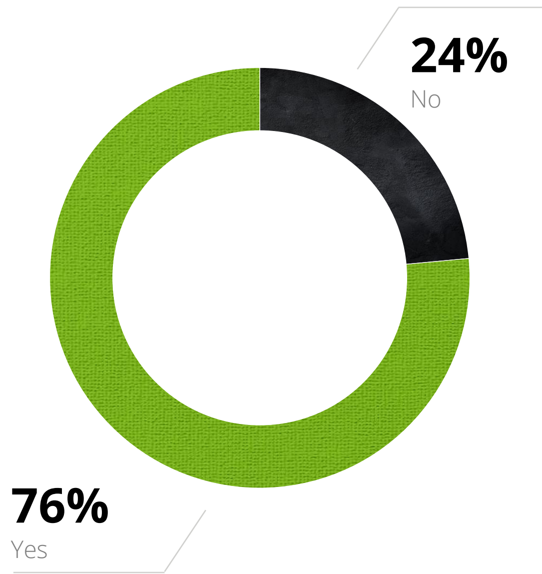
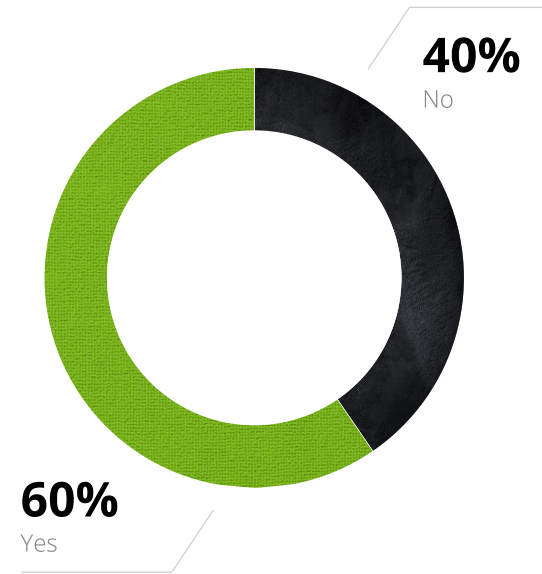
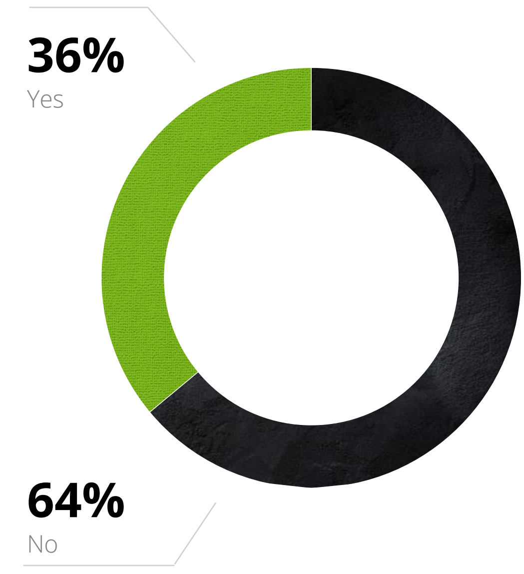
Representations & Warranties (R&W)



Repeated as at Closing



Limited (at least some R&W) by Knowledge Qualifier (Seller's Knowledge)



Limited by Disclosure through Disclosure Letter

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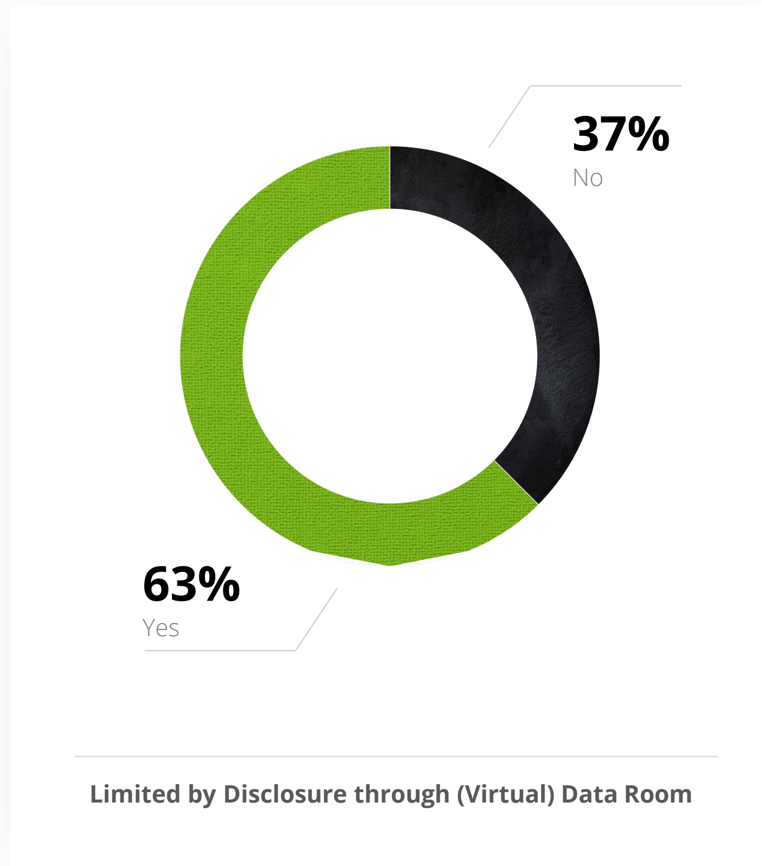
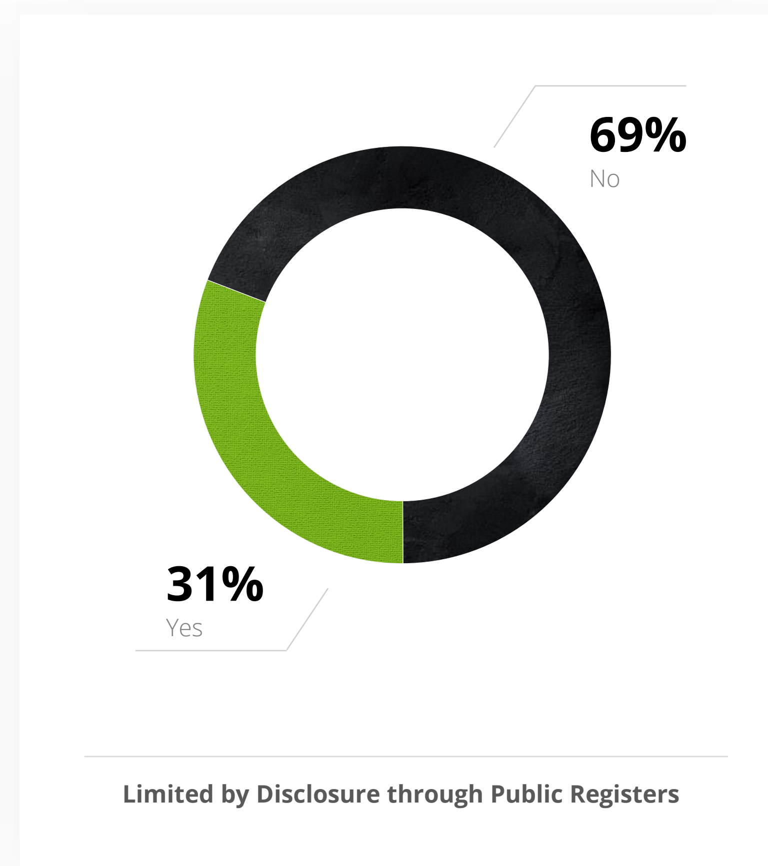
Representations & Warranties (R&W)





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Material Adverse Change (MAC)

MAC clauses generally grant the purchaser the right to, in the event of a material adverse change ("MAC" for short), either under certain conditions withdraw from the already signed but not yet closed purchase agreement or to establish corresponding guarantee claims.

The legal forms of MAC clauses can be very different. They are often negative, thus, subsequent closing conditions, the occurrence of which depends on the non-existence of a MAC event up to the time of closing. This closing condition is usually accompanied – like also any other closing conditions – by a right to withdraw from or rescind the agreement, so that the purchaser can refrain from closing the transaction and withdraw from the purchase agreement if not all the closing conditions have been fulfilled by a certain date (the long stop date).

A MAC clause may be designed as a guarantee given by the seller, which, in the event of a MAC event occurring between the signing and closing, gives rise to a claim of the purchaser under the representations and warranties.

Our study shows that MAC clauses have been used in **63%** of M&A transactions in the Central European region.

From the study we observe diverse uses of MAC clauses, namely: (i) **24%** are with other unspecified contractual instruments; (ii) **18%** are with MAC and R&W breach; (iii) **12%** are with MAC alone; and (iv) **9%** are with an R&W breach only.

For example, in Austria, generally, MAC clauses have been used in **33%** of the time, while MAC only were used in **22%** of the M&A transactions. The most common use is MAC only, while MAC and R&W breach, and MAC with other instruments, share the same positions.

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Material Adverse Change (MAC)

In Romania, there is a use of MAC clauses in **70%** of the transactions where MAC only is predominant over other uses of MAC.

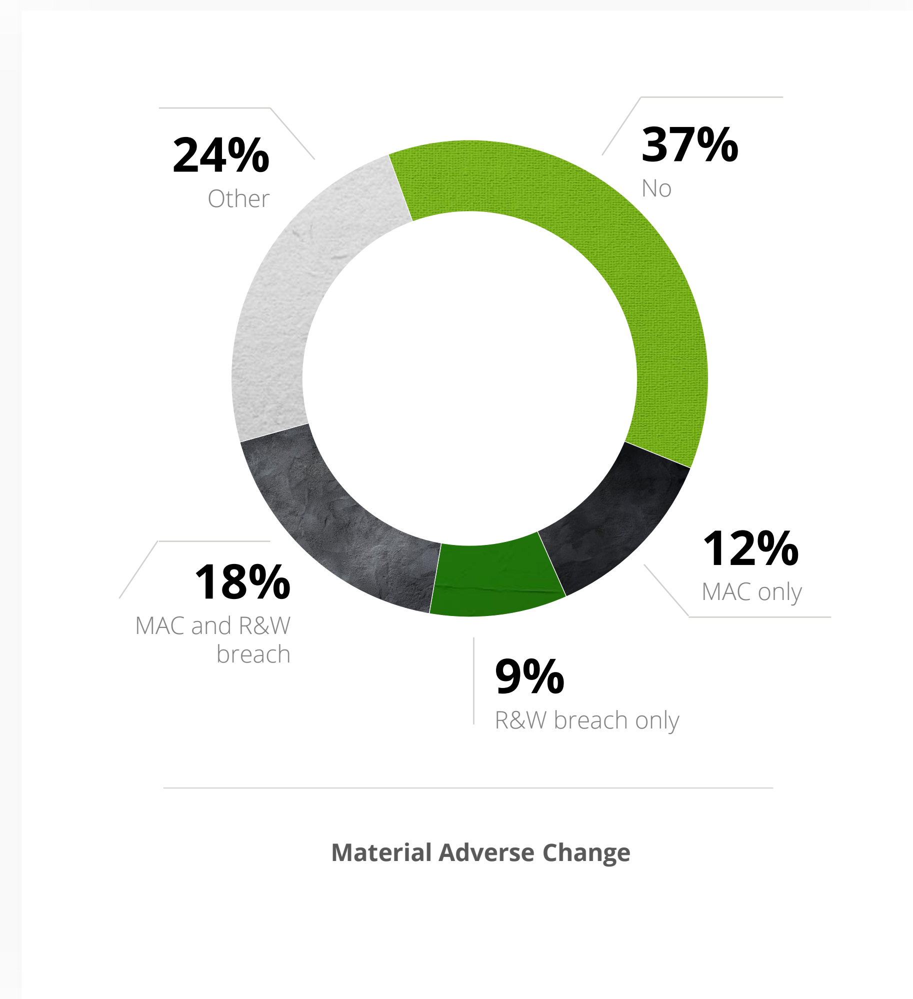
For Bulgaria, MAC and R&W breach are dominant, and to a lesser degree we can identify the use of R&W breach only. A similar trend can be seen in Croatia.

In the Czech Republic, which comprises the largest number of M&A deals analysed, MAC clauses have been included in **52%** of the SPAs. In the most common cases, MAC clauses have been used with other contractual instruments, more specifically: (i) **17%** are with other unspecified contractual instruments; (ii) **14%** are MAC only; (iii) **14%** are MAC and R&W breach; and (iv) **7%** are an R&W breach.

Poland has a clear division on the use of MAC clauses whereby the application of MAC and R&W breach and R&W breach only is equally **50%.**

Hungary is a jurisdiction in which all transactions included in the study are with MAC clauses with other unspecified contractual instruments. The same applies to Serbia whereby the same form is applied in all transactions.

It is important to emphasize that in certain jurisdictions (such as Albania, Kosovo, Slovenia, and Latvia) MAC clauses have been used in **100%** of M&A transactions. The trend of using MAC clauses in the abovementioned jurisdictions has mostly been implemented in combination with other contractual instruments.



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Indemnities

Indemnities are a relatively frequent buyer remedy accompanying representations & warranties and were negotiated and included in 63% of the deals which were taken into consideration in our study.

Relevance:

- This remedy is for specific risks identified by the buyer.
- These risks are based on an uncertain, future event.
- The identified risks do not need to be reflected in the purchase price.
- The seller will indemnify the buyer for the losses incurred in case the event occurs. Only the actual losses suffered by the target are recovered (as opposed to expected or estimated losses that are reflected in the purchase price).
- The applicable monetary and time limitations of the indemnities can be tailored to the specific risks identified by the buyer.
- There are limitations on specific indemnities: limitations on liability commonly do not apply to specific indemnities ("euro for euro").
- Some examples of indemnities would include pending litigation, a tax audit, an identified breach, or GDPR incompliance.
- 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.

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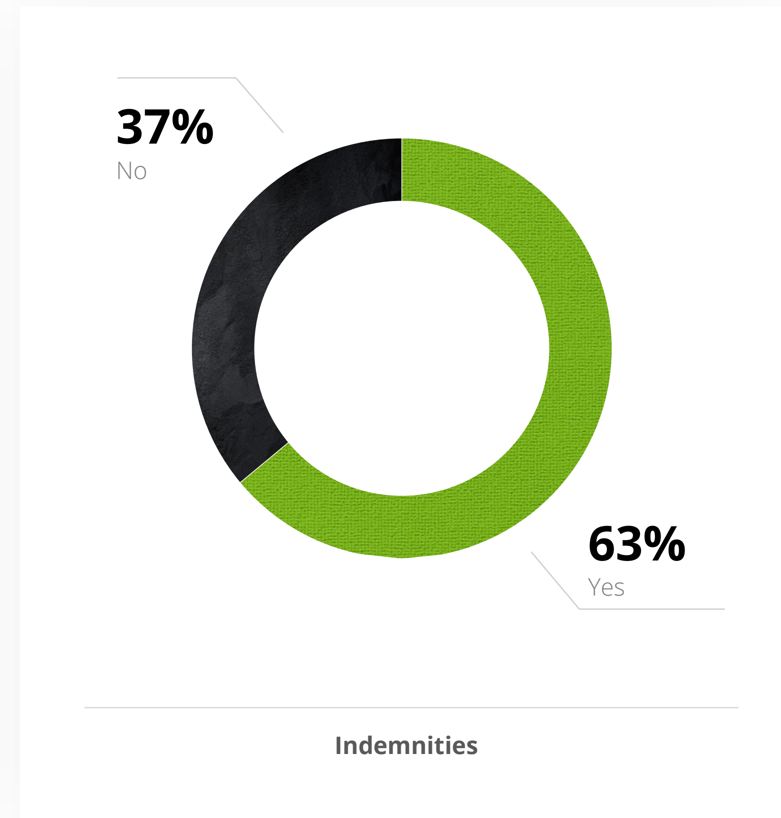
Indemnities

- As an alternative, buyers may seek indemnities for 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 materialize.
- Our study revealed that indemnities were negotiated and included in **63%** of the deals, showing that in most 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 (the 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 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 the characteristics of the individual risks.



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Warranty & Indemnity Insurance

Warranty & Indemnity insurance (W&I 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 this study, W&I insurance was arranged only in **12%** of the deals and **88%** of the reviewed deals did not include this instrument. There are countries where none of the transactions that we studied has W&I insurance arranged, e.g., in Austria, Poland, and Slovenia. However, transactional parties in Kosovo and Bosnia and Herzegovina tend to use this instrument more frequently than in others.

W&I insurance has several advantages for transactional parties. Generally, it allocates risks arising under the deals to the insurer, thus the parties can have a higher level of comfort regarding their transaction.

From a seller's perspective, this insurance limits the seller's liability post-closing, thus a clear-cut separation of the seller from the target can be managed. From the buyer's perspective, it can mitigate concerns over the seller's financial position, capability, or availability to cover potential warranty & indemnity claims. In addition, where otherwise, the transactional parties would have a hard time to agree on the allocation of the risks, W&I insurance can facilitate the negotiations be-tween them.

Furthermore, W&I Insurance can expedite the acquisition's financing as well, because in our practice, due to the above advantages, financing banks generally welcome warranty & indemnity insurance.

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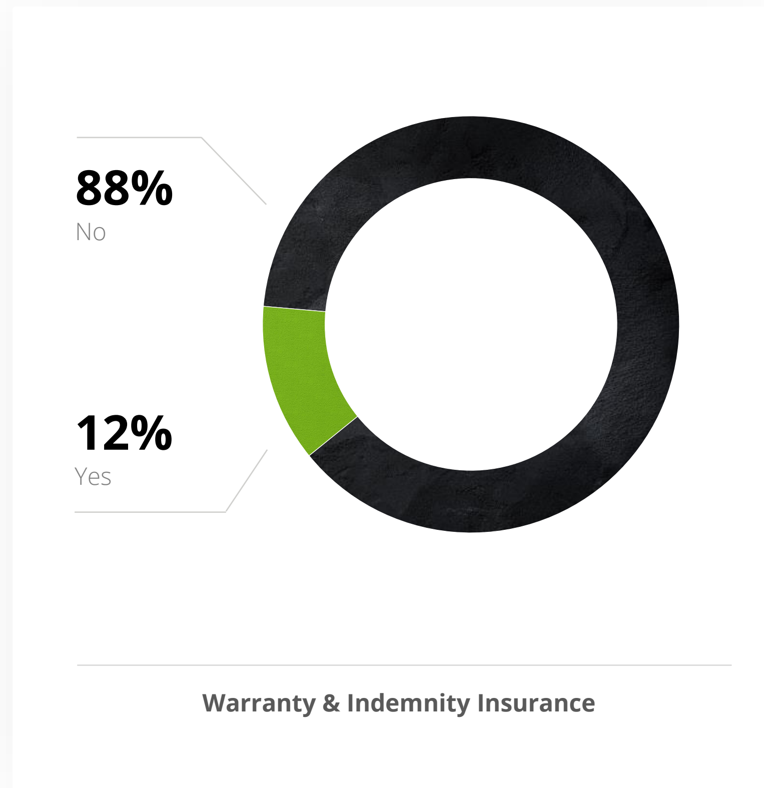
Warranty & Indemnity Insurance



On the other hand, the above advantages come with a cost, some other aspects of W&I insurance can be disadvantageous to the transaction. Generally, insurers would need some information to decide whether to provide insurance or not. Therefore, the insurer will typically instruct an external le-gal counsel to (i) review the disclosure process; (ii) review the due diligence process and due diligence reports; (iii) review the SPA and disclosure letter; and (iv) comment on any other transaction specifics that appear abnormal.

Furthermore, insurers would likely need to have a consultation with both the transactional parties as well as their legal counsels to have a clear view of the transaction and the relevant warranty & indemnity provisions. As a result of the above, arranging insurance could be rather time-consuming and costly.

To summarize, we can establish that W&I insurance can be advantageous, and that transaction parties tend to use it in the Central European region, but that it remains applied only in a minority of the transactions in the region.

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Limitation of liability for breach of R&W

De-minimis

In extensive M&A deals it is important to evaluate whether every breach of R&W is significant enough to be pursued. It is in the best interest of all parties of the deal to limit potential liabilities, as long disputes and litigations regarding insignificant breaches can cause significantly larger losses than the loss caused by the breach itself.
One of the tools to be used in M&A deals is the *de-minimis* clause.

A *de-minimis* clause describes the agreed material threshold which must be reached for claims regarding breach of R&W to be eligible. Meaning, the *de-minimis* threshold will limit potential individual small claims arising from breach of R&W. This protects the seller from receiving many minor claims that are inconsequential compared to the agreed renumeration amount and decreases the general number of legal disputes regarding insignificant amounts, cutting potential legal costs. It is important that *de-minimis* clause usually is expressed as a ratio to purchase price and usually does not exceed **0.35%** of the agreed price.

Research in relevant cases in Central Europe has shown that **41%** of reviewed share purchase agreements include a *de-minimis* clause that has a ratio less than **0.1%**, and in **13%** of cases the *de-minimis* clause is not applicable at all.
Only in **13%** of the cases the ratio of purchase price has been from **0.21%** to **0.35%**. Effectively, in a large amount of reviewed cases there is no or almost no material threshold that must be reached for a claim to be raised. In deals where the *de-minimis* clause is applied, the typical threshold is less than **0.2%** of the purchase price across the Central European region.

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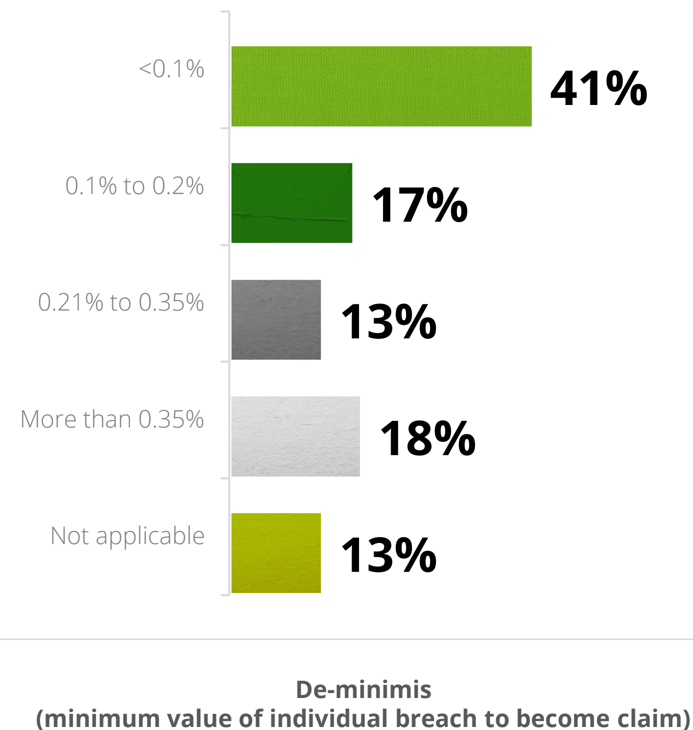
Limitation of liability for breach of R&W

In isolated deals the *de-minimis* ratio to purchase price has even reached **8%**, but it can be considered highly atypical. From 16 Central European countries reviewed, Lithuania has the highest *de-minimis* ratio to purchase price – while the clause was only applied in 50% of the reviewed M&A deals, in deals where it was applied, the range of the ratio is from **1%** to **8%**.

However, when evaluating the Baltic states as a whole, there is an ongoing trend for *de-minimis* clause ratio to decrease. Compared to 2016, the amount of threshold per claim has slightly decreased, and only rare deals see a ratio above **1%**. It is typical for M&A deals in the Baltic states to make claims eligible *at the first dollar*, not setting a minimal threshold at all.

It is reasonable to conclude that when evaluating examples available, the *de-minimis* ratio to purchase price in Central Europe M&A deals is usually set under **0.2%**. Such an approach helps to prevent lengthy legal disputes about insignificant amounts, hence reducing potential losses for parties involved, but also demonstrates a strong level of protection if R&W breaches occur.



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Limitation of liability for breach of R&W

Basket

Our study shows that the use of baskets as a limitation of liability for breach of representations and warranties continues to be a common practice in M&A transactions across the whole of the Central European region. It is usually applied in correlation with a *de-minimis* provision. Although we also noticed that *de-minimis* provisions are now applied to a greater extent than a basket. We also see a tendency that parties tend to agree to not apply the basket clauses in those transactions where warranty and indemnity (W&I) insurance is used. Almost all the transactions considered having W&I insurance had no de minimis and basket provisions.

A basket represents a threshold amount (the agreed fixed sum) of all breaches in aggregate that a buyer must incur before it is entitled to any indemnification from the seller. Symbolically, all claims are put in a basket and can only be reimbursed once the threshold is exceeded. Baskets can serve significant purposes, such as the protection of the seller from the submission of many minor claims for compensation, as well as the minimization of the number of legal disputes between the parties over minor amounts, compared to the agreed purchase price.

Baskets can be structured in two different ways – as a tipping basket (first dollar) or as a deductible (excess only). With a tipping basket (first dollar), once the agreed amount is reached, the indemnifying party is liable for the total amount of losses. With a deductible (excess only) basket, once the agreed amount is reached, the indemnifying party is only liable for the amount of losses in excess of the respective amount. Although our study does not go into detail on the prevalent types of thresh-old, typically baskets in Central Europe tend to be structured as a tipping basket (first dollar), as op-posed to a deductible (excess only) basket threshold.

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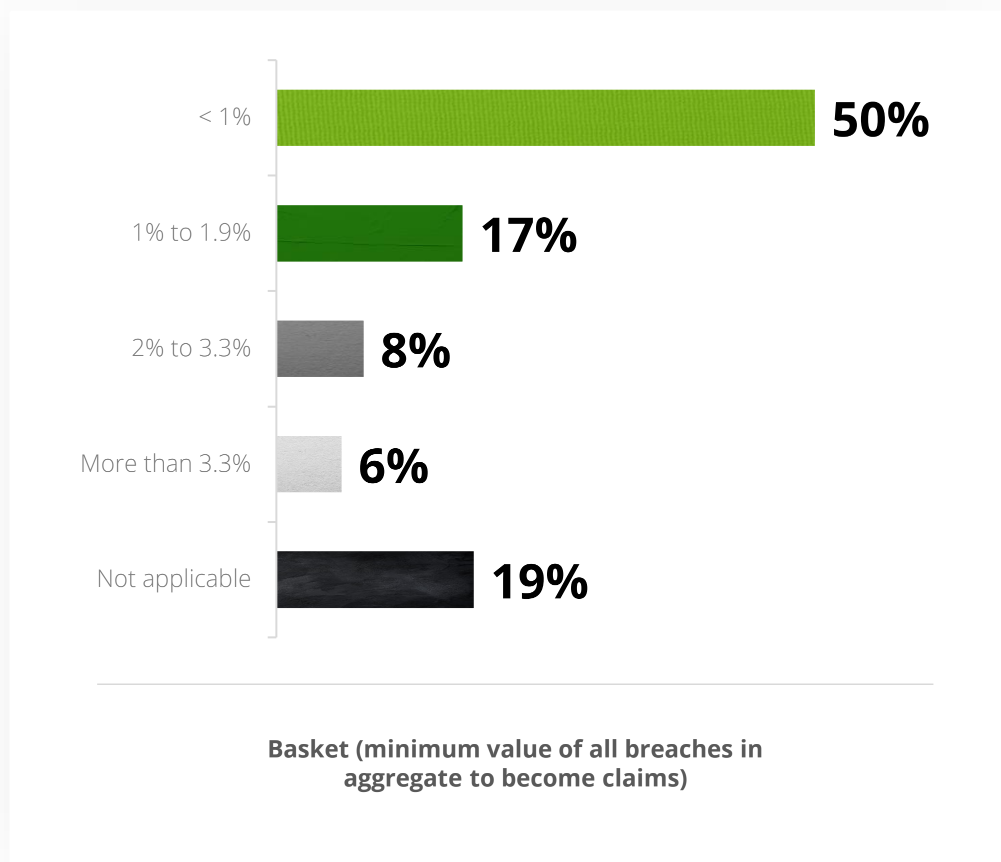
Limitation of liability for breach of R&W



Our SPA study shows that the basket threshold in the Central European region generally does not exceed **3.3%** of the purchase price. The most widely used basket threshold in the Central European region is less than **1%** of the purchase price (in **50%** of all transactions).

However, we observe that the average basket threshold in Austria is slightly higher, varying from **2%** to **3.3%** of the purchase price. Also, the average basket threshold for the targets engaged in the manufacturing industry is significantly higher than in comparison with other industries (**2.3%**). As for the Baltic region, we see that a basket provision is used in almost all considered transactions and that the most widely used basket threshold is up to **1.9%** of the purchase price.

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Limitation of liability for breach of R&W

Cap

In the M&A transactions concluded in the Central European region, there is a tendency showing that the cap (the maximum amount to be claimed) of the fundamental and title R&W - ratio to purchase price most commonly amounts to **100%**. More rarely, it is not applicable or equals **50%** or even less.

As for the ratio to purchase price of the cap of the other and ordinary R&W, the results are definitely diverse. The most common amounts are **10%**, which is found in nearly 3 out of 10 transactions. Nearly **50%** of transactions included a liability cap ranging from **10%** to **20%** of the purchase price and nearly two thirds of transactions included a liability cap ranging from **10%** to **40%** of the purchase price or lower.

The cap of the tax R&W - ratio to purchase price is most commonly lower than for the fundamental R&W, or similar as for the fundamental R&W. It is rarely higher than for the fundamental R&W. It deserves mentioning that it is not applicable in nearly 1 out of every 5 M&A transactions.

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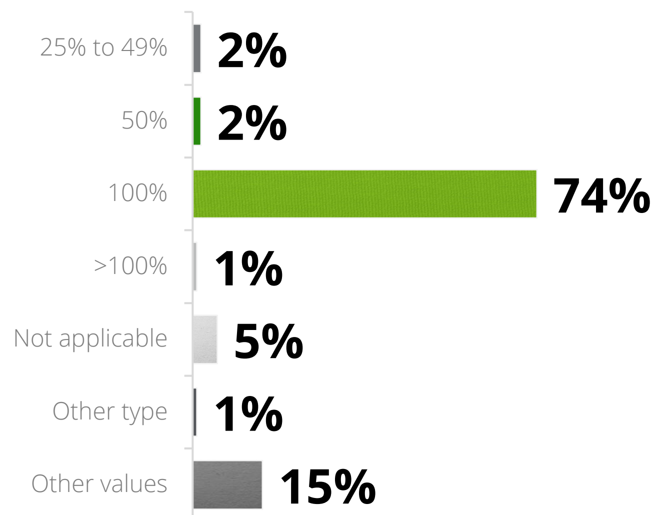
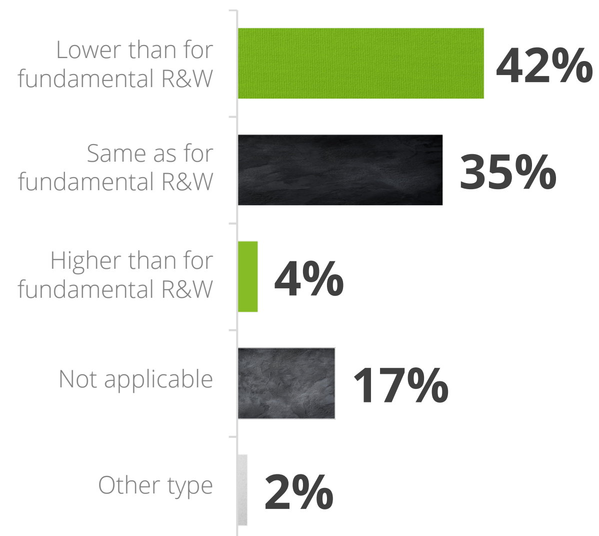
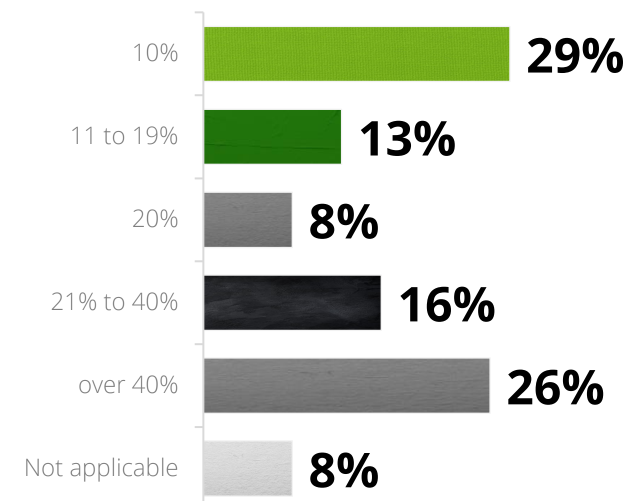
Limitation of liability for breach of R&W



Cap (maximum amount to be claimed)
Fundamental / Title R&W
Ratio to purchase price



Cap (maximum amount to be claimed)
Tax R&W
Ratio to purchase price



Cap (maximum amount to be claimed)
Other / Ordinary R&W
Ratio to purchase price

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Time limit

To raise claims from breach of Fundamental/Title R&W; Other/Ordinary R&W; Tax R&W

It is a customary practice on the M&A market that sellers aim to limit their exposure to potential liability under the SPA by providing representation and warranties (R&W) on: (i) aspects pertaining to the title to shares, core assets as well as to other aspects of utmost importance for the business (Fundamental R&W), (ii) tax liabilities attached to the business (Tax R&W) and (iii) general aspects pertaining to the overall business (Ordinary R&W).

Our study revealed that this type of limitation of liability is expressly agreed upon in the vast majority of the deals subject to the study.

While time limitations applicable to the buyer's right to raise claims from the breach of R&W is included in most of the deals in the region where the study was performed, differences arise with respect to the specific period of time (starting from the closing date of the transaction) within which the buyer is entitled to notify a claim under the SPA.

Our study has revealed in a rather consistent manner the trends in the region on the specific time limits to raise claims from a breach of R&W:

a) The time limitation to raise claims for breach of Fundamental R&W is typically between 3-5 years in **36%** of the reviewed deals. The fact should be noted that such a time limit is less than 3 years in **26%** of the deals included in our study and longer than 5 years in **25%** of the reviewed transactions. Based on this split, we may conclude that the market practice for time limits to raise claims from a breach of Fundamental R&W across the region is of a term between 3-5 years.

b) The time limitation to raise claims for breach of Tax R&W is, in most of the countries included in our study, shorter than the statute of limitation term applicable to tax liabilities in the relevant jurisdictions. To this extent, in **37%** of the reviewed deals, the time limit for raising claims for breach of Tax R&W is up to or equal to 3 years, although the statute of limitation term for tax liabilities is significantly longer – typically 5-6 years, running from 1 January of the year following the year when the tax obligation should have been paid.

   In some jurisdictions, like in Romania and Poland, where the statute of limitation term for tax liability is 5 years or more, the market practice indicates that the time limit for Tax R&W is typically equal to such a statute of limitation term. However, in all cases, this exceeded 3 years. To this extent, in **31%** of the deals included in our study the contractually agreed time limitation to raise claims for breach of Tax R&W is set for a duration longer than 3 years, and up to 5 years, as of the closing of the transaction.

   It should further be noted that, depending on the contingent liability of the target for tax liabilities as assessed within a due diligence exercise, the Tax R&W may be qualified in the SPA as Fundamental R&W.

c) The time limitation for raising claims for breach of Ordinary R&W is generally less than 2 years in **64%** of the analyzed deals, while in **16%** of the deals such a term was set at between 3 -5 years. This shows a specific degree of consistency on this topic across the countries included in our study.

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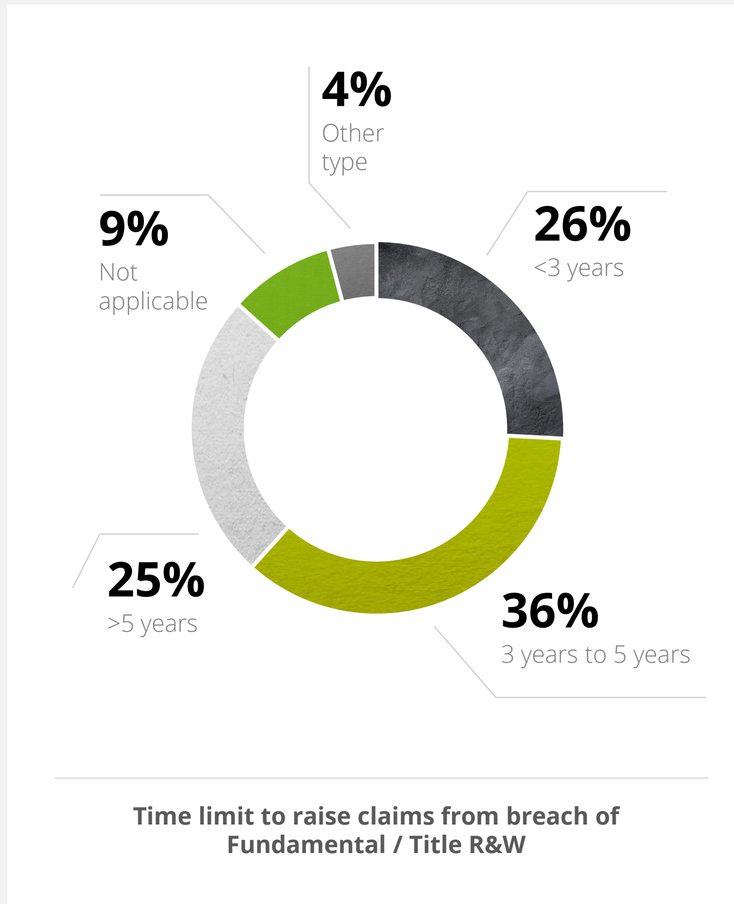
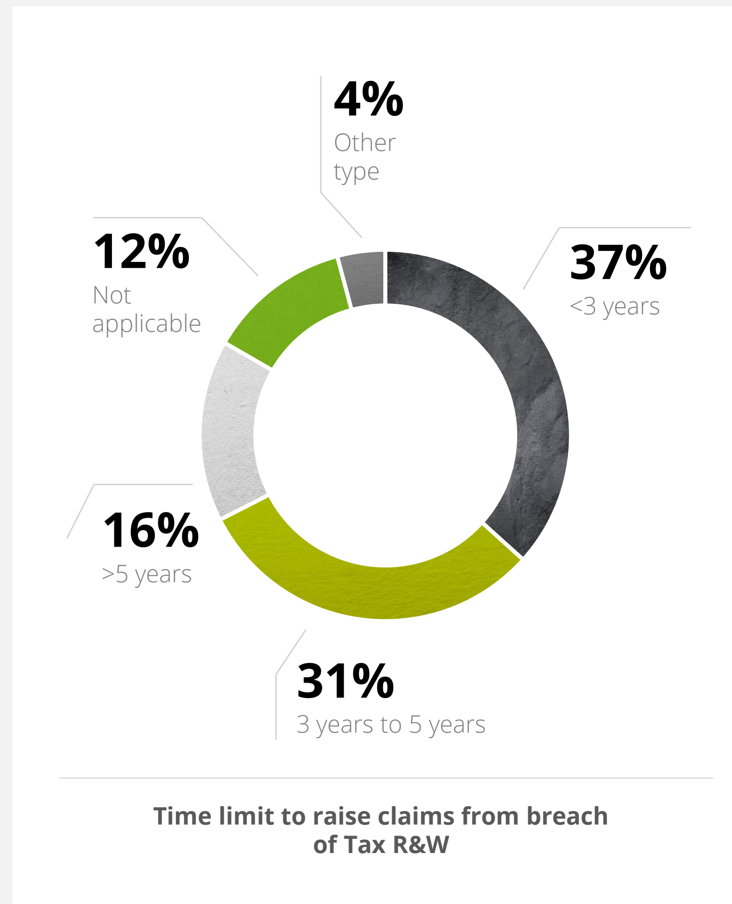
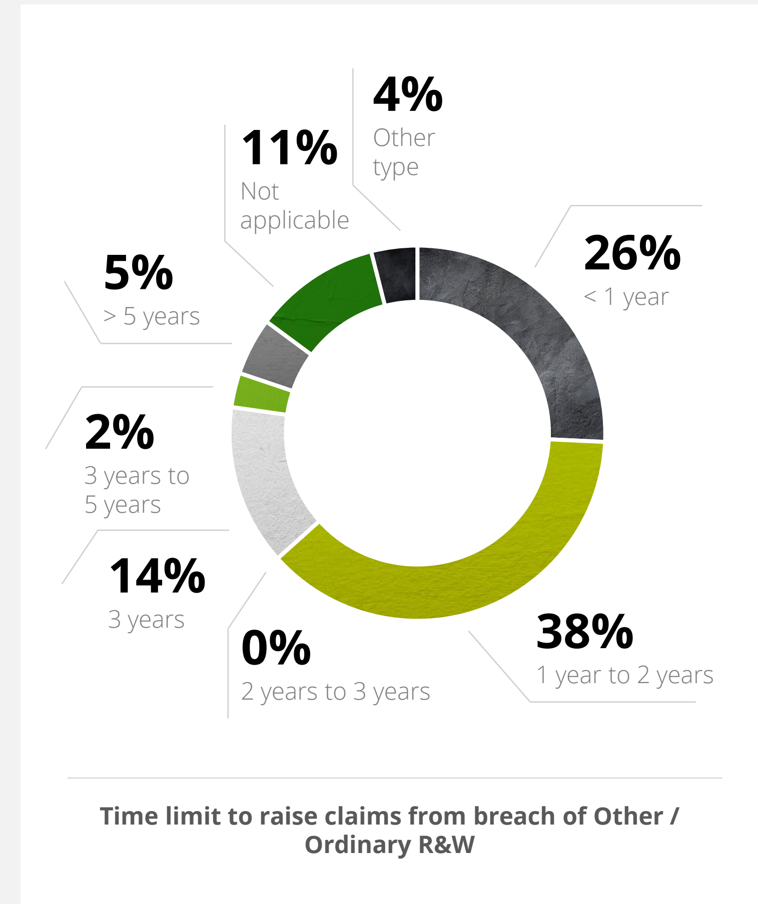
Time limit



Time limit to raise claims from breach of Fundamental / Title R&W



Time limit to raise claims from breach of Tax R&W



Time limit to raise claims from breach of Other / Ordinary R&W

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Non-compete clause

A non-compete obligation is a covenant through which a certain time period limits the seller (and its related parties) from:

(i) competing with the target company or the acquired business, and

(ii) soliciting customers and/or employees from the target company or the buyer.

Key aspects of each non-competition covenant are:

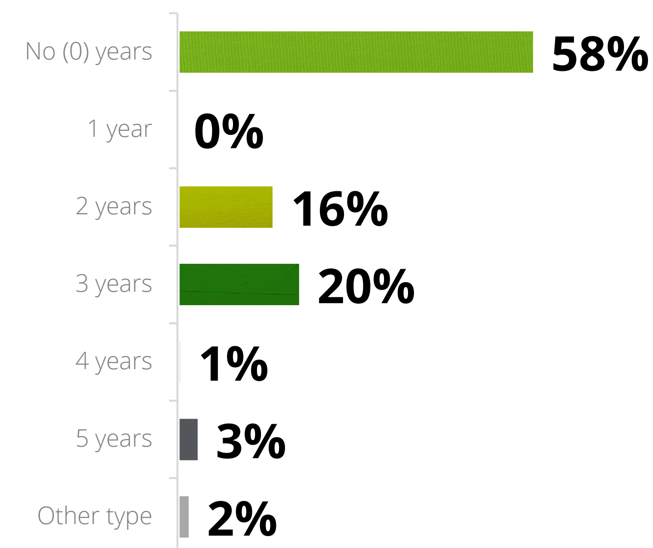
- protect the economic rationale of the acquisition (e.g., allowing the buyer enough time to take over and stabilize the business so that it can fully utilize the acquisition), and
- balance the time and geographical limits appropriate to the characteristics of the relevant transaction and the market.

Normally, this covenant is used when acquiring companies or businesses. Still, we have noted that non-compete covenants were only agreed in less than a half of the M&A deals surveyed. Specifically, around **42%** of the deals provided for some sort of non-compete covenant.

As a rule, agreed non-compete covenants were limited to a 2-year or 3-year period. Available exceptions further confirm this rule. Specifically, non-compete covenants exceeding a 3-year period were agreed on in deals with very specific circumstances.

To that end, given the applicable anti-trust regulations and publicly available practice in Central Europe, any non-compete covenants exceeding a 3-year period should be methodically analyzed and carefully drafted.

When drafting non-compete covenants, parties should sufficiently restrict business activities of a competitive nature to the business activities of the target. In particular, it should be assessed whether the restricted business activities are properly defined by listing the relevant product markets and whether the non-compete covenant covers the whole territory of the target's (core) business.



Non-Compete Clause
Duration of non-compete clauses

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Governing law

Many M&A transactions have a significant international element to them. This can occur where the parties are not all located in the same jurisdiction and the target company is in a different jurisdiction to the buyer or the seller. This also occurs where the governing law of the SPA is different from the jurisdiction of any of the parties. Such a situation enhances the necessity to draft the governing law clause in the SPA in a clear way so that the governing law is easy to determine with no reasonable doubt from the parties or the courts.

A governing law clause states which law will govern the SPA. This extends not just to the interpretation of its clauses but also to the validity, effect, and termination of the SPA. The clause should also govern the parties' non-contractual rights.

Parties are generally able to nominate the governing law of their choice in the SPA and this will usually be upheld by the courts of the country where the dispute is held. Based on our experience, the clients ask for advice to be sure that a chosen governing law clause will operate successfully in the event of a dispute.

Even though it is not a general rule, we would advise that the governing law should match with the respective jurisdiction of the general courts chosen by the parties. It should be noted that the general courts should always apply the law chosen by the parties, even though the choice of foreign law (different from the law of the country where the dispute is held and decided) may prolong the dispute which then normally takes months or years based on the complexity of the case. Such a situation is caused by the fact that the general court must study a foreign law which is not commonly known in the respective jurisdiction.

Problems can arise in the event of a contractual dispute if no governing law has been chosen. The rules determining the 'default' governing law can be very complex and may not lead to the result the parties would have chosen. In addition, the choice of law will need to be settled as a preliminary question possibly delaying the proceedings and potentially increasing costs.

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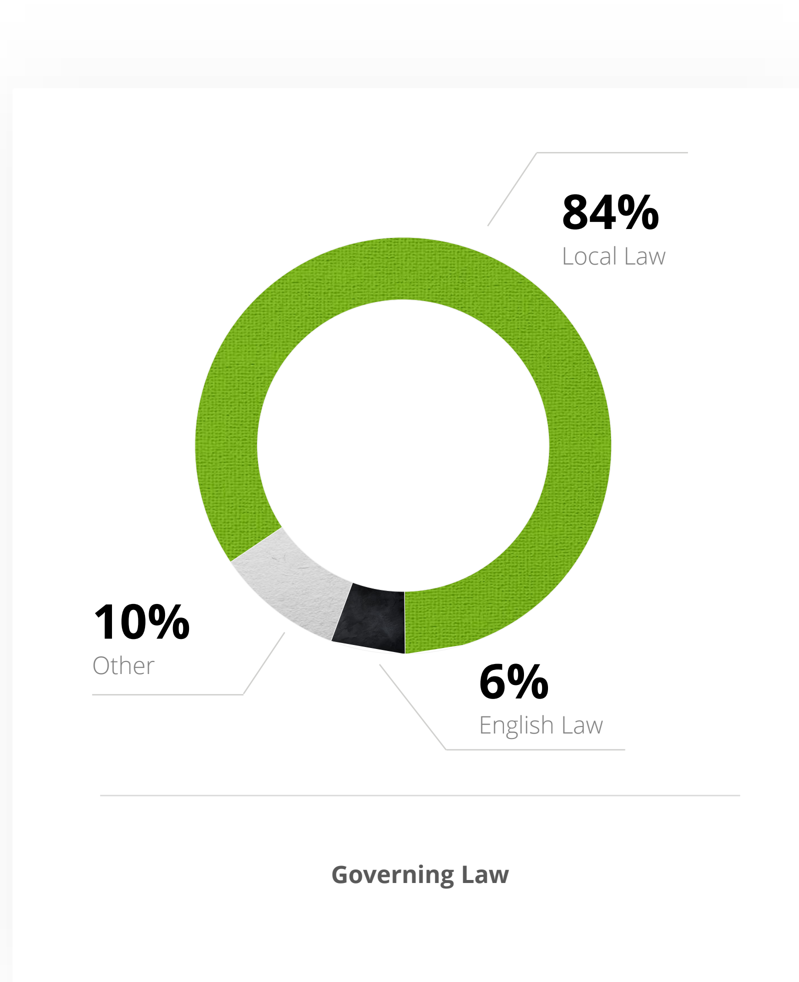
Governing Law



In the EU, Rome I provides rules to determine the applicable law where no choice has been made. A court within the EU must always apply Rome I whenever it must decide which law applies to a contract (SPA).

Most of the SPAs within our study were governed by the local law where the target or one of the parties is seated.

The parties generally chose the target´s local law, and if not, it must be assured that no provision of the target´s local law is in contradiction with the SPA. In some cases, the parties choose the governing law of the country where one of the parties has major activities and its business is related to that country, rather than choose a country where the target itself is seated. In cases when all the parties and target are from different jurisdictions, the latest trend is to choose English law. We generally see such clauses in banking documents for syndicated loans provided by multiple banks. However, this trend is rapidly reaching the M&A market.

Notwithstanding the governing law chosen by the parties, it must be assured that no provision of the SPA is in contradiction with the mandatory provisions of the chosen governing law.

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Arbitration/Common courts

Choosing between arbitration and state courts is a traditional issue in M&A transactions. In most cases, the parties weigh the pros and cons of both manners for resolving potential disputes. Our study reveals that in **49%** of the analyzed SPAs the parties chose arbitration, in **51%** they agreed upon common courts to resolve their potential dispute(s).

In nine out of 16 jurisdictions in the Central European region, namely: Albania (**100%**), Bosnia and Herzegovina (**100%**), Croatia (**100%**), Latvia (**100%**), Poland (**100%**), Slovenia (**100%**), Bulgaria (**88%**), Hungary (**80%**), and Lithuania (**80%**), arbitration is the preferred option. As such, the advantages of arbitration are as follows: (i) the ability to choose arbitrators, who may be specialists, as well as impartial and fair (ii) the flexibility of the proceedings and language used, (iii) generally faster proceedings, (iv) confidentiality of the proceedings (in principle), (v) the effect of choosing a neutral venue, and (vi) high enforceability, are all widely recognized.

For example, in Bulgaria we observe that arbitration agreements in M&A transactions are most common in cross-border transactions, where the parties seek a neutral forum or are concerned about the enforceability of decisions and judgements issued by state courts in some or all jurisdictions involved in the respective transaction. In the latter case, the parties tend to rely on arbitral awards as being enforceable in most countries under the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

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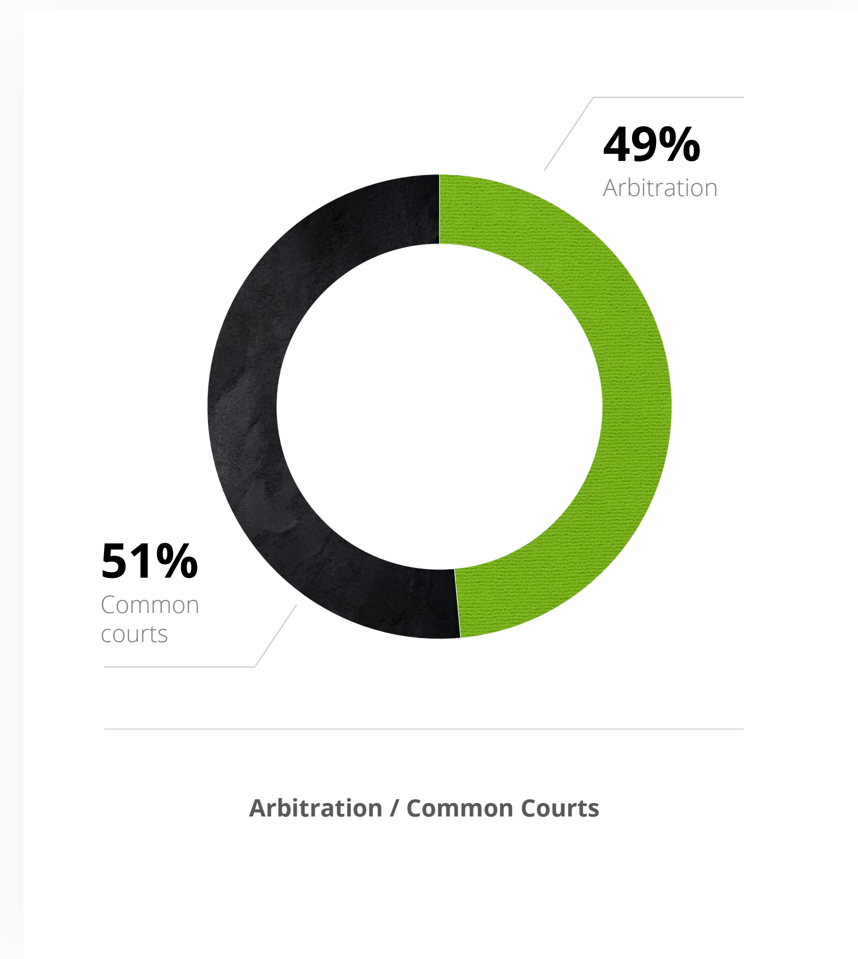
Arbitration/Common courts

On the other hand, dispute resolution before the common courts is still at the forefront in Kosovo (**100%**), Austria (**93%**), Serbia and Montenegro (**82%**), Slovakia (**71%**), and the Czech Republic (**57%**), whereas Romania has a balanced ratio of **50%** to arbitration and **50%** to common courts.

We have identified several reasons for common courts being a preferred option in respective Central European countries, namely: (i) a higher level of trust in domestic common courts compared to foreign arbitration, mainly due to familiarity with local legislation and court practice, (ii) the cost effectiveness of common courts, and (iii) the potential risk of unenforceability of the arbitration agreement in the case of a consumer being involved in an M&A transaction.

Additionally, based on the analyzed SPAs in Serbia and Montenegro, dispute resolution by common courts is preferable (**81.8%**), since the majority of the deals included in this study are small to medium-sized M&A deals, concluded between domestic clients, that are accustomed to using local courts.



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Advice throughout every stage of your transaction

Deloitte Legal advises businesses throughout every stage of a transaction, from negotiation through to execution.

End-to-End M&A

We align with our tax and finance colleagues to cover risks from all angles. We review the transaction with an investment case focus and provide end-to-end guidance, which can include but is not limited to support during the following critical phases:

- Sourcing
- Screening
- NDA
- First review
- LOI / NBO
- Due diligence
- Compliance due diligence
- Legal structuring
- Binding documentation, completion & closing
- Anti-trust filing/merger control clearance
- Post M&A integration
- Capital market compliance

Joint Ventures & Strategic Alliances

Deloitte Legal advises clients through any and all phases of a transaction. We apply our deep industry experience to deliver bespoke legal due diligence services. In addition, we provide advice on suitable structures, as well as the drafting and negotiating of relevant agreements and ancillary documents in both private and public transactions.

Deloitte Legal also assists companies with negotiation and execution of shareholder agreements relating to the regulation and structure of governing and managing bodies, resolutions subject to qualified majority, control restrictions on the transfer of shares and dividend policies.

We assist in transactions through completion, including support with anti-trust filings, obtaining other relevant regulatory approvals, and local implementation.

Legal Project Management

Transaction activity can trigger a wave of responsibilities for a client's legal professionals. We bring our project management experience to bear to support clients with any number of activities. Among the areas we provide project management support are:

- Asset allocation
- Liability split and allocation
- Intercompany services
- Employee matters
- Intellectual property assets
- Sales force
- Local corporate governance

Our detailed project management methodology includes five phases (plan/assess, gather data, define structures, prepare plans for each structure, implement), and is fully transparent to each client's defined key stakeholders every step of the way.

Post-Merger Integration

Once a deal closes, it is essential to effectively integrate the businesses and structures of the entities in order to realize the intended benefits of the transaction. Deloitte Legal helps companies rationalize and simplify corporate structures and internal proceedings for the integrated group.

We support clients with intra-group mergers, carve-outs, legal entity simplification or rationalization, squeeze-out procedures, and alignment of internal rules and regulations for the group resulting from the transaction.

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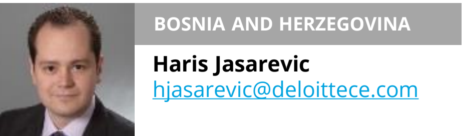

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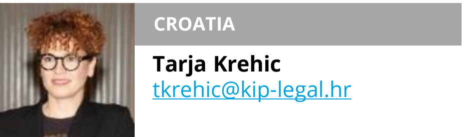

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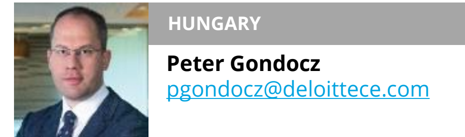

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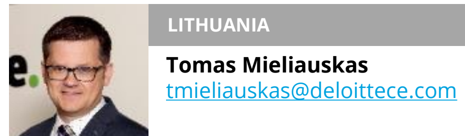

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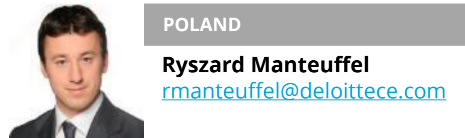

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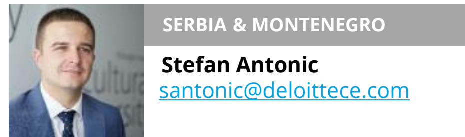

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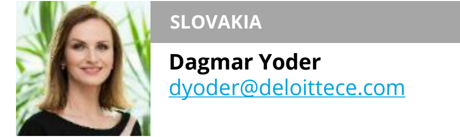

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In this study, we have gathered information from M&A deals with which Deloitte Legal has been involved with from 2019 up to mid-2021. When gathering the information, we have relied on final drafts and, where not available, on advanced drafts of the relevant SPA. In order to compile this study, we needed to generalize certain legal elements of the available draft SPA. Although such generalization is possible to a 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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