

Luxembourg

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M&A activity in Luxembourg dropped considerably in the first half of 2020 alongside a global slowdown due to Brexit and the Covid-19 crisis. Recovery has begun at a slow but stable pace since the second half of 2020.

Since the beginning of 2021, the impact of the pandemic has decreased and cross-border M&A deal volume in Luxembourg market and/or through Luxembourg vehicles into other markets has resumed. There has been a rebound of shareholder activism in the market, which has encouraged deals in various sectors apart from the fund industry, such as cargo transportation and logistics, automotive and engineering, as well as technology, media and telecommunications.

Due to the legal and political stability of Luxembourg's regulatory, financial and legislative framework, and the growing fund industry and financial sector, the Luxembourg market continues to generate further M&A transactions aimed at European-based targets.

There are a mix of private and public M&A transactions, while the key sectors for M&A activity remain diverse. The deal volume for Luxembourg itself is rather small and mostly in the financial sector; however the number of M&A deals steered through Luxembourg vehicles into other markets remains very good.

M&A targets in both the private and public sectors are often not located in Luxembourg itself but in other jurisdictions. Due to the stable and positive legal and business environment in Luxembourg, M&A transactions with European targets orchestrated from a Luxembourg-based structure (investment fund or other) continue to be common.

In April 2021, a notable transaction saw SMS Group, a German plant engineering company for the metals industry, fully acquire the remaining 40.8% shares of Paul Wurth, which were previously held by the Luxembourg state and state-owned banking organisations. Following the takeover, SMS Group has become the sole shareholder of Paul Wurth's plant engineering business, strengthening its competence in metallurgy and hydrogen technology.

Moreover, in July 2021 Danske Bank A/S entered into an agreement with Union Bancaire Privée, UBP SA (UBP) on the sale of the business activities of Danske Bank International S.A. (DBI) in Luxembourg, which was expected to result in a one-off gain for Danske Bank of approximately Kr250 million (approximately \$37 million). The sale was completed in January 2022.

Furthermore, in the financial sector additional M&A between asset management companies appeared. TMF Group completed the acquisition of Selectra Management Company. Also, VP Bank acquired certain business portfolios from other players to increase its private wealth client business.

Economic recovery plans

The market has recovered in terms of M&A deal flows in 2021. This is evident in the significant increase in the volume of net assets under



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management of investment funds in Luxembourg for 2021 and especially with regard to private equity (PE) funds.

Inbound/outbound M&A patterns, deal volume and values and sector-specific activity will be driven by the changes and potential changes in legislation and policy (see below).

During the Covid-19 pandemic, parties may structure M&A deals differently. It is prudent for sellers to look into the material adverse change clause (MAC) carefully, as there could still be a high possibility that the Covid-19 pandemic qualifies as a MAC and purchasers attempt to terminate the transaction on that basis. The due diligence procedure is also severe and onerous since there is the need to assess deeper the financial conditions and the situation of target companies due to the invisible impact of the Covid-19 pandemic.

Moreover, it is important for the parties, having negotiated the purchase price of the target company during the pre-Covid-19 period, to ensure that it is still considered fair for the value exchanged. Otherwise either party or both parties may attempt to renegotiate or terminate the deal.

Tying a portion of the purchase price to the performance of the target company after closing, i.e. earn-out provisions, might be a way to give purchasers a degree of security and certainty. An agreement on the allocation of risk on earn-outs may be a suitable compromise to save certain deals as well as to diminish the impact of Covid-19.

The investment funds industry continues to play a major role in the Luxembourg financial and legal market. As of December 31 2021, the total net assets of undertakings for collective investment, comprising UCIs, specialised investment funds and SICARs, amounted to €5,859.485 billion (approximately \$6.5 billion).

The volume of net assets rose by 17.81% in the last 12 months, which is significant compared to the increase of 5.4% for the year 2020. These funds have been investing and will generate further M&A transactions aimed at mostly European-based targets.

Luxembourg has seen an increase in special purpose acquisition company transactions in 2021 though the listing mostly occurred at non-Luxembourg stock-exchanges. However, it remains to be seen if this conduit vehicle is in fact a favourable instrument for investors given the uncertainty of investing into a platform that is not yet fully determined or equipped.



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Marcus specialises in investment funds, PE and venture capital as well as corporate and M&A law. He regularly speaks at investment fund events and is also a member of the Cross-Border Business Lawyers Network.

Marcus studied at Rostov-na-Donu State University and Saarland University and is qualified in both Germany and Luxembourg.



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Kate studied at the East China University of Political Science and Law, at the Erasmus University Rotterdam and at Bologna University. She also speaks Chinese and is qualified to practice in China.

Legislation and policy changes

The key legislation is the law of August 10 1915 on commercial companies, as amended (Corporate Law).

The Corporate Law provides for all kinds of corporate entities and corporate instruments to create tailor-made structures usable for M&A transactions. The Corporate Law has introduced new forms of corporate entities, further enhancing corporate structuring via Luxembourg as a platform. The special limited partnership (*société en commandite spéciale*) and the simplified private limited liability company (*société à responsabilité simplifiée*) are examples of this.

Another key piece of legislation is the law of May 19 2006 implementing Directive 2004/25/EU on takeover bids, as amended (Takeover Law), which covers squeeze-out and sell-out rights and contributes to M&A transactions of Luxembourg-based target companies. A natural or legal person acquiring, alone or with persons acting in concert with it, control over a company by holding 33.3% of the voting rights is required to make a mandatory takeover bid to all the holders of shares in the Luxembourg company.

As far as the competent authority is concerned, the Takeover Law states that if the target company's securities are not admitted to trading on a regulated market in the EU member state in which the company has its registered office, the competent authority to supervise the bid will be the authority of the member state responsible for the regulated market on which the company's securities are admitted to trading.

The law of July 21 2012 governing the mandatory squeeze-out and sell-out of securities of companies admitted or previously

admitted to trading on a regulated market, or having been offered to the public (Luxembourg Squeeze-Out and Sell-Out Law) also plays a role.

The Luxembourg Squeeze-Out and Sell-Out Law applies to the following scenarios:

- If all or part of a company's securities are admitted to trading on a regulated market in one or more EU member states; or
- If all or part of a company's securities are no longer traded, but were admitted to trading on a regulated market and the delisting became effective less than five years ago; or
- If all or part of a company's securities were the subject of a public offer which triggered the obligation to publish a prospectus in accordance with Directive 2003/71/EC of the European Parliament and of the Council of November 4 2003 on the prospectus to be published when securities are offered to the public or admitted to trading (Prospectus Directive) or, if there is no obligation to publish according to the Prospectus Directive, where the offer started in the previous five years.

The Luxembourg Squeeze-Out and Sell-Out Law does not apply during, and for a certain grace period after, a public takeover, which is or has been carried out pursuant to the Takeover Directive.

Also, numerous treaties on the avoidance of double taxation allow Luxembourg to support the worldwide M&A activities of Luxembourg PE funds and M&A parties.

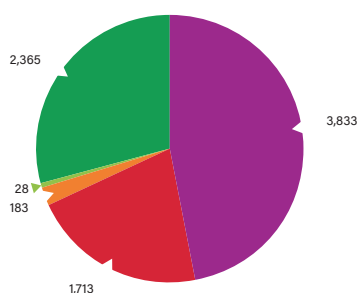
On March 21 2020, the Luxembourg parliament passed a law implementing Council Directive (EU) 2018/822 of May 25 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (DAC6), which is applied as

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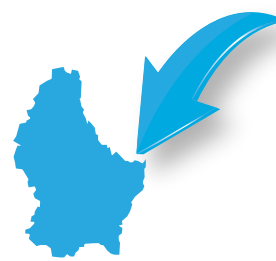
OUTBOUND



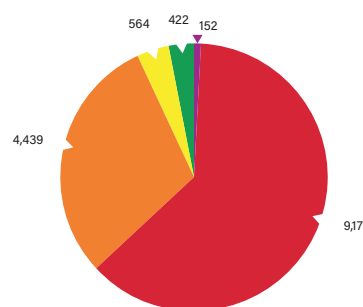
\$8,122m



INBOUND



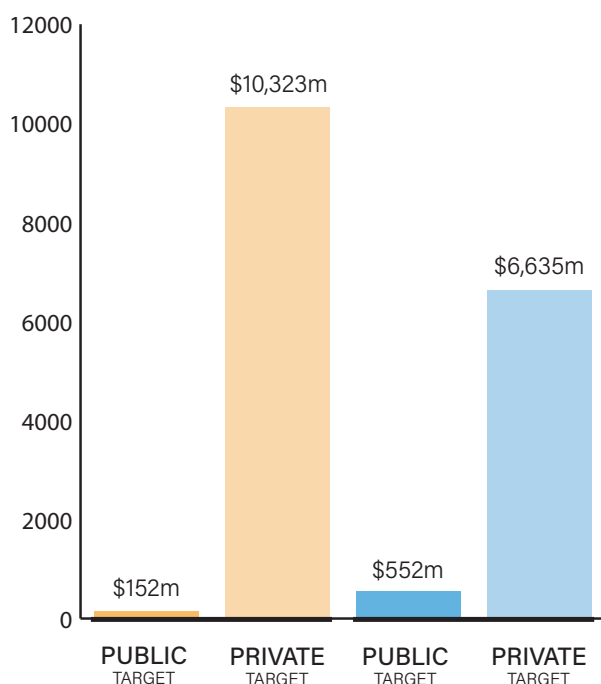
\$14,756m



NB only deals with publicly disclosed values are represented in the charts and infographics

- Consumer products
- Healthcare
- Leisure and hospitality
- Energy and natural resources
- Industrial goods
- Professional services
- Financial services and investment management
- Infrastructure and public services
- Telecoms, media and technology

INBOUND OUTBOUND



NB: Values may exclude certain transactions, for example asset acquisitions/sales

of July 1 2020. DAC6 tightens the reigns on M&A deals across the globe, as the previous method of cross-border M&A tax structuring in terms of the review of the share purchase agreement, tax structuring upon acquisition, cash repatriation strategies upon sale, etc., need to be re-considered for various purposes and in particular transparency.

Identifying DAC6-reported M&A transactions and structuring advice need to be included in tax due diligence assignments and the framework of decision making. Closing deliverables and the purchase price mechanism need to reflect such change and be amended and structured to accommodate possible risks following fines that may be imposed due to non-compliance with DAC6 reporting regulations.

On July 17 2020, the law of July 10 2020 creating a register of fiducies (fiduciary arrangements) and trusts entered into force. It transposed Article 31 of Directive 2015/849/EU as amended by Directive 2018/843/EU, thereby introducing a series of measures increasing the transparency of the beneficial ownership of trusts, fiducies and similar legal arrangements. It provides, in particular, for the mandatory registration of certain personal data on the beneficial owners of trusts and fiducies in a newly created register of fiducies and trusts, managed by the *Administration de l'Enregistrement, des Domaines et de la TVA* (the Luxembourg registration duties, estates and VAT authority).

The register complements the register of beneficial owners established by the Law of January 23 2019 creating a register of beneficial owners for legal entities registered in the Luxembourg Trade and Companies Register. This might have a major impact on

M&A transactions where the structures are tailored- to hide the beneficial owners of the purchasers following the sale for tax or other purposes.

On December 30 2020, the EU and China reached an agreement in principle on the EU-China Comprehensive Agreement on Investment (CAI), which places an emphasis on providing access to the Chinese market for European investors. Both sides have been continuing separate negotiations on investment protection to be completed within two years of the signature of the agreement, and on March 12 2021 the European Commission published the schedules of commitments agreed under the CAI.

The CAI will ensure fair treatment for EU companies in the Chinese market and enable more cross-border deals between the EU and China, to create a better balance in the EU-China trade relationship. The framework is likely to be key in helping the Luxembourg and EU markets to recover.

On September 15 2021, a bill (no. 7885) was adopted to implement Regulation (EU) 2019/452 of the European Parliament and of the Council of March 19 2019, introducing a screening mechanism with a mandatory notification and pre-approval requirement for certain foreign direct investments made by non-European investors in a Luxembourg entity operating in a critical sector in the territory of Luxembourg. The bill affects foreign investors that wish to invest in a Luxembourg entity conducting activities on the Luxembourg territory regarded as critical in various sectors (e.g. energy, health, defence, finance, telecoms, data and media).

The investors concerned will be required to inform the competent authorities of their intention to make investments in critical infrastructure and provide certain information prior to the proposed investment. The competent authorities will then perform a preliminary analysis, on a case-by-case basis, which may lead to a screening procedure to assess whether the investments are likely to affect security or public order, and a decision will be taken to either prohibit or allow the investment. The bill will also have an impact on M&A transactions by influencing which sectors foreign investors focus on.

Furthermore, given the importance of the investment fund industry in M&A transactions, the entry into force of EU Regulation 2019/2088 of November 27 2019 on sustainability-related disclosure in the financial services sector and Regulation 2020/852 of June 2020 on the establishment of a framework to facilitate sustainable investment, may indirectly affect the M&A market.

The implementation of effective environmental, social and governance (ESG) policies and strategies by target companies may influence the attractiveness of investee companies, and will enhance due diligence procedures to ensure that the target companies comply with ESG standards and disclosure requirements.

On January 20 2022, the Luxembourg Ministry of Economy launched a public consultation on the possible implementation of a merger control regime in Luxembourg. The purpose of such a regime would be to give the Competition Council the power and the tools to carry out an ex ante control of certain M&A or other alignments between undertakings which may have a restrictive effect on competition in Luxembourg, and to allow for early detection of such threats to competition, potentially limiting damage to consumers and undertakings alike. The Ministry of Economy has working in close collaboration with all affected ministerial departments on this subject, and is expecting to introduce a bill after completion of preparatory works in 2022.

Market norms

Common questions in Luxembourg relate to the best choice of PE fund vehicle for an M&A activity. Tax is always an important element when setting up a structure. The structure needs to be tax- and DAC6-compliant, serve the interest of the investing group and target entity and consider the upcoming legislative initiatives of the EU. In this regard, any future changes proposed by the European Commission to tax regimes applicable to M&A structuring must be closely monitored.

Technology makes negotiations and deal closings easier for parties who are not residing in the same country. Some law firms use

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artificial intelligence (AI) software to conduct legal due diligence. AI software enables rapid identification and extractions of key provisions by reviewing thousands of contracts and other documents quickly. However, advanced technology is not a substitute for human beings, rather a tool to allow us to get deals done more quickly and efficiently, and often at a lower cost.

Public M&A

Key factors for public M&A involve complying with the provisions of the Takeover Law. This includes complying with the requirement to notify supervising authorities and with reporting requirements under the law, as well as with other elements related to the activity. In particular, parties to an M&A transaction need to assess how the managing bodies of the takeover target are to be approached and which governmental authorities need to be notified.

The market practice in Luxembourg regarding break fees shows that break fees are regularly negotiated at the beginning of a transaction. This is common in Luxembourg and it is also accepted by Luxembourg service providers that a break fee can include a certain discount, given the economic downside of an unsuccessful bid.

Private M&A

The concepts mentioned above also apply to Luxembourg private M&A transactions. The locked-box mechanism might span a minimum period of six months to two years. Completion accounts need to be presented and they may be audited. Earn-out provisions to give purchasers more security and certainty are commonly seen especially during the Covid-19 pandemic for the purpose of risk allocation as well as diminishing the impact of Covid-19. A growing number of private M&A transactions can be seen in financial sector entities such as alternative investment fund managers and banks.

In private takeovers, deal conditions are subject to specific transactions. All conditions, however, must comply with the applicable law and should be identified duly in advance of starting the deal. The Corporate Law provisions apply, as do the constitutive

documents of the privately owned target entity. A shareholders' agreement will most likely also be put in place and this will contain provisions pertaining to drag-along, tag-along and pre-emptive rights of shareholders.

Parties to M&A transactions are inclined to have the share purchase agreement governed by and construed in accordance with the law of the country where the target entity is located. Share purchase agreements involving Luxembourg-based target entities are typically drafted under and made subject to Luxembourg law.

Exit strategies remain the standard ones. Initial public offerings (IPOs) are often prepared as an exit strategy; however, a sale is often preferred to an IPO. Sales to strategic sponsors are rare, however sales to or among PE firms are increasingly common.

Looking ahead

M&A transactions regained their previous speed at the end of 2021. Apparently, the overall M&A market in the European Union was better than in 2007 (i.e. before the financial crisis). This is a good sign and gives hope for 2022. However, given the rising political tensions between Russia, Europe and the United States there might be a slow down with a view to M&A activities also in and through Luxembourg.

Covid-19 should not be a major obstacle to M&A activities anymore provided Omicron is not substituted by a more dangerous virus variant. Climate and ESG, although posing transactional risks, will become an opportunity for M&A transactions. The companies and investors that are facing ESG disconnect and potential ESG risks for the moment will have to seek alignment with counterparties to solve ESG integration issues by acquiring or merging with ESG-adjacent assets and activities.

Investment in fintech and in early-stage technology, such as space companies in Luxembourg, is also likely to increase. A steady number of M&A transactions are expected, including in Luxembourg. However, M&A transactions launched from Luxembourg vehicles into other EU jurisdictions will remain more important and voluminous than M&A transactions within the Luxembourg market itself.