

# M&A REVIEW

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www.ma-review.de

Publikationsorgan **BUNDESVERBAND  
MERGERS &  
ACQUISITIONS EV.**

Vol. 33, 2022

**MuMAC**  
Munich M&A Conference

M&A REVIEW 9/2022 Special

## International Perspective

Portfolio optimisation in turbulent times – creating and utilising windows of opportunity

Driving value in M&A

Carve-outs in a disruptive environment – disruption as a driver of economic change processes

Implications of the UK's National Security and Investment Act 2021

Democratisation of Alternatives

ESG and private equity: How integrating ESG fast and efficiently can boost transparency for both General and Limited partners

## Advertorial

Intelligent private company data, supporting the M&A target sourcing process

## Germany

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Sustainability and German MidCap Finance Market

Notification Obligations for Foreign Investments in the German Health Sector

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The German Government's Start-Up Strategy – Ambitious Goals, Much to Do

## Conference Agenda

2022 Cross-Border M&A and Private Equity Conference



## MuMAC Special 2022

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# #MuMAC 2022: What is up with Private Equity and M&A?

## 1. MuMAC 2022

On September 20, 2022, MuSAC in conjunction with PwC, Dealsuite and McDermott Will & Emery as main sponsors, will host the 2022 annual Cross-Border M&A and Private Equity conference MuMAC from the Bayrischer Hof in Munich. After a "dry period" of two years of pandemic faulted only video-streamed MuMAC, we dare and go live and in-person again. We are aiming to welcome some 300 in-person participants and some 500 virtual participants that will join the live stream of the conference session in the main ballroom.



## 2. The Game-change

The global crisis caused by Covid-19 had, and continues to have, a material impact on economies and societies, causing mass-vaccinations of the population of this world, contact restrictions as well as necessitating education and work from home.

2022 brings back the war to Europe – as Russia has invaded the Ukraine in an act of fierce violation of international law. Civilians and soldiers are dying again, in European cities and on European battlefields. Is this a déjà-vu of times, behavior and attitude we all believed to be conquered and consigned to history? What will the ripple effects of geostrategic shifts be on the transactional sphere?

As a complimentary add-on, inflation shakes the European and national economies in a manner that we had hoped to belong to the past. The effects on business models and operations are still difficult to evaluate.

Whereas 2021 brought an astounding Private Equity and M&A transactional upheaval, in the H1 2022 we can watch a significant decline in deal count and deal value for EMEA. Are we experiencing the "Gamechange – The Transactional Ripple Effects"?

## 3. The conference features

MuMAC 2022 will focus on all these features. We will have an opening statement and greetings of the

Ukrainian Consul General Yuriy Yarmilko in Munich – followed by a keynote of the former head of NATO's Strategic Foresight Team, Professor Stefanie Babst.

Panels will cover the cross-border M&A markets in Europe (with a supplement on CEE) and the US, in Asia, the famous German Mittelstand, and further the sectors healthcare, life science, energy and infrastructure, technology, digital and AI and transaction financing. Other panels and speakers will address crises opportunities, ESG as new deal component, IP and patent valuation, Finance Function as value driver, Supply Chain 2.0 and Corporate Litigation and Litigation Finance.

Pandemic, war, geostrategic shifts and inflation are having a dramatic impact on the world and on the Private Equity and M&A landscape. We have experienced in our country that light at the end of the tunnel breaks out once the war is fought and the reconstruction begins. We hope that in one way or another the war quickly comes to an end and mankind will find its rational path again. With our MuMAC conference we hope to contribute one mosaic stone to a return to collaboration and constructiveness. ■

With our very best regards

*Dr. Nikolaus von Jacobs*

*Christian von Sydow*

Publikationsorgan

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**Special MuMAC 2022**  
**Supplement to M&A REVIEW 9/2022 (Vol. 33)**  
[www.ma-review.de](http://www.ma-review.de)

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**Publication Organ:**  
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**Cover:**  
 Photo: © jozefmicic – stock.adobe.com

**Publisher:**  
 M&A Media Services GmbH  
 Habenschadenstraße 24a, 82049 Pullach, Germany  
 Phone: +49 (0)89 74975133  
[redaktion@ma-review.com](mailto:redaktion@ma-review.com), [www.ma-review.de](http://www.ma-review.de)  
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 Text & Design, Zielstattstraße 117, 81379 München

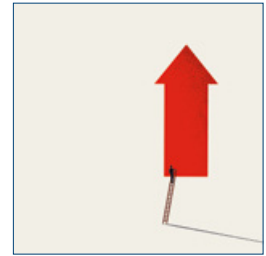
**Editing:**  
 Magdalena Aderhold, visavis media, Bayreuth,

**Printing:**  
 Joh. Walch GmbH & Co. KG, Im Gries 6, 86179 Augsburg (Germany)

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# Portfolio optimisation in turbulent times – creating and utilising windows of opportunity

Tobias Huesmann, PwC & Prof. Dr. Dirk Schiereck, Technische Universität Darmstadt

## 1. Introduction

▶ Corporate environments have become increasingly volatile, uncertain, complex and ambiguous (VUCA), with new challenges emerging every year. New regulations, changing consumer preferences, technological shifts, new environmental threats and geopolitical conflicts have become ubiquitous in markets around the world.

To guide executives through these volatile markets and help them assess how well their corporate portfolio delivers their corporate strategy, PwC Germany developed the portfolio optimisation approach. By assessing strategic fit, one can identify both underperforming business units and areas of strategy that have not been implemented. Based on this assessment, executives can then decide on ongoing strategic measures to enhance their company's competitive positioning, to ensure that corporate portfolios deliver maximum returns, and to provide robustness against future volatility.

## 2. Market environment

Recent cases of volatility, such as the Covid-19 pandemic and the outbreak of war in Ukraine, illustrate the development of VUCA all around the world. This is having a severe impact on fundamental issues in corporate planning, and executives need to find ways to successfully navigate these VUCA waters. It is unanimously predicted that future markets will become even more opaque, and that increasingly high-impact volatility will occur more frequently. Therefore, executives will need to constantly monitor and analyse key planning issues, as failure to adapt to external changes has the potential to undermine corporate strategy.

The ability of corporate decision-makers to quickly adapt corporate strategies to new market conditions and to ensure that corporate portfolios meet strategic

goals will be even more essential for long-term success. As a result, it is vital for organisations to move towards more adaptive, risk-optimising and quick-to-implement approaches to strategic management. Promoting inorganic growth will become more important than organic growth, given its greater speed and impact.

## 3. Corporate strategy

Executives have identified a paradigm shift in business, from the traditional market view of continuous growth in stable environments to the VUCA market view of rapidly changing market conditions. These rapid changes make stable forecasts and anticipating market trends more difficult, so executives need more adaptive and short term-focused corporate strategies to best exploit market opportunities and mitigate risk.

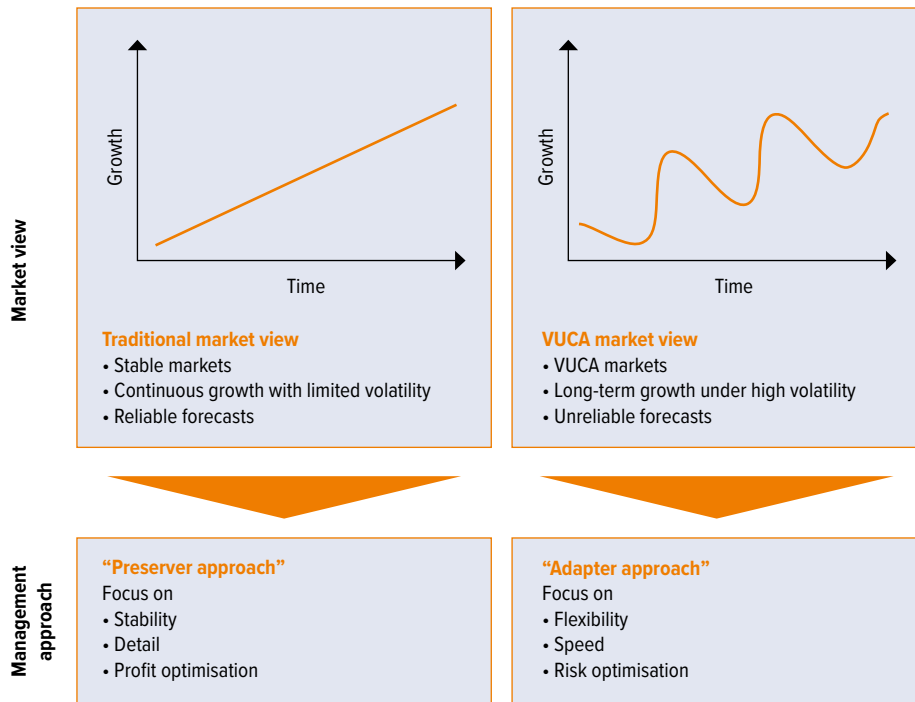
As PwC's recent portfolio management study shows<sup>1</sup>, the proactive "adapter approach" (flexibility, speed and risk optimisation) is now more common than the more traditional view and its "preserver approach" (stability, detail and profit optimisation; Fig. 1). This indicates that the need for change in overall management approach is recognised in the market, and the relevance of adapter criteria is especially well understood once executives are aware of the extent of VUCA.

Despite this, executives lack strategic clarity and hence fail to consistently implement the adapter approach when it comes to making inevitable choices (e.g. speed vs. detail, flexibility vs. stability). Volatile market developments, however, require bold strategic moves and confident leaders who won't shy away from making choices and tackling corporate inertia to take essential measures.

<sup>1</sup> PwC, PwC Portfolio Management Study 2022, Optimism in uncertain times – will reality soon catch up with corporate executives?, 2022, [www.pwc.de/en/deals/portfolio-management-study.html](http://www.pwc.de/en/deals/portfolio-management-study.html).

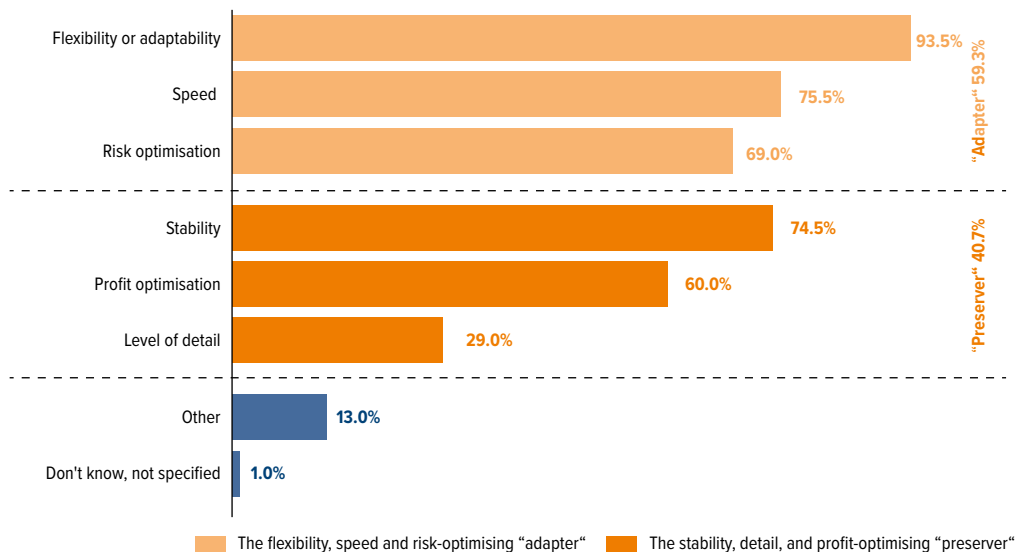
**Fig. 1 • Traditional and VUCA market views and management approaches**

Source: Own illustration



**Fig. 2 • Most important criteria for developing corporate strategy over the next five years**

Source: Own illustration



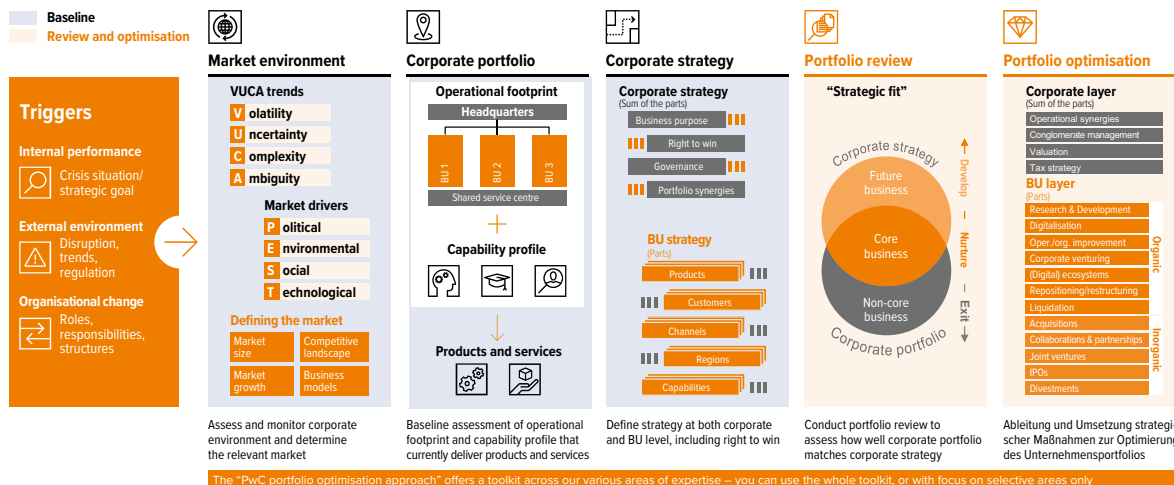
**4. Fundamentals of portfolio management**

To adapt to today’s ever-evolving market, PwC Germany developed a portfolio optimisation approach (Fig. 3). This guides executives through volatile markets by assessing how well their current corporate portfolio fits their agreed corporate strategy.

The first step is to analyse the relevant market environment and review the company’s competitive position in this environment, while also assessing whether the company’s strategy is suitable to best exploit market opportunities and mitigate risks. Using this baseline, the portfolio review stage reveals the strategic fit of the corporate portfolio – i.e. how well the corporate strat- ➤

Fig. 3 • PwC’s portfolio optimisation approach

Source: Own illustration



egy has been implemented. Assessing strategic fit identifies both underperforming business units and areas of the strategy that have not been implemented. Based on this assessment, executives can then decide on ongoing measures to enhance their company’s competitive positioning, to ensure that corporate portfolios deliver maximum returns, and to provide robustness against volatility strikes.

PwC’s unique approach to supporting executives with portfolio reviews comprises the following fundamental steps:

1. Translate strategic goals into measurable and objective evaluation criteria that, overall, approximate the company’s strategy (e.g. financial, strategic and operational goals).
2. Weigh up each criterion and prioritise according to the strategic goals, set hurdle rates accordingly.
3. Transform corporate goals into ambitious yet realistic business unit objectives.
4. Conduct a performance review that compares actual performance to target performance in order to show how well the strategic goals are being achieved.

Finally, all organisational units are categorised into future, core and non-core business areas, based on the strategic fit assessment. Future business areas consist of elements that are included in the company’s strategy, but are not yet part of the corporate portfolio. Core business areas comprise the part of the portfolio that is in line with corporate strategy, which typically make

up the bulk of the business. Non-core business areas are currently part of the portfolio, but are not in line with company strategy: as a result, exit options should be evaluated for non-core units.

### 5. Strategic measures

Once this tailored portfolio review has been carried out, strategic measures need to be developed for optimising the company’s corporate portfolio. Future business areas need further development, core business areas must be nurtured and optimised, and non-core business areas should be divested to free up capital.

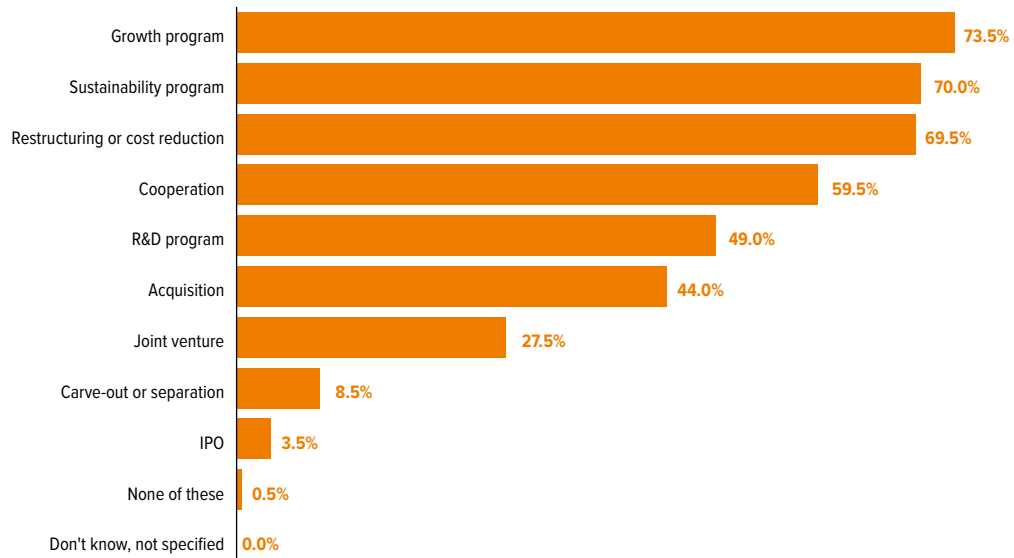
In a VUCA market, executives are expected to make the right choices and consistently implement their decisions. It is important to note that there are two sides to VUCA: on the one hand, it threatens stability and adds complexity; but on the other hand, it creates windows of opportunity to foster transformative change and overcome corporate inertia.

All strategies and operations in a company should support long-term corporate success. Measures for organic growth (e.g. R&D programmes, restructuring) utilise the company’s internal resources and limit risk exposure, while measures for inorganic growth (e.g. acquisitions, carve-outs) allow for quick, bold and high-impact strategic moves. Figure 4 is based on data from PwC’s latest portfolio management study 2022<sup>2</sup>, and shows the main corporate development measures planned by executives over the next five years.

2 PwC, PwC Portfolio Management Study 2022, Optimism in uncertain times – will reality soon catch up with corporate executives?, 2022, www.pwc.de/en/deals/portfolio-management-study.html.

**Fig. 4 • Main corporate development measures planned for the next five years**

Source: Own illustration



According to the study results, measures to promote organic growth only lead to moderate improvements in a company's financial position, yet the right subset of inorganic growth measures can have a major effect in helping companies to outperform their competitors. Overall, "adapter" companies which were able to follow their strategic pathway by driving inorganic transformation in their portfolios – such as carve-outs or acquisitions – achieved excellent financial results.

However, the portfolio management study also revealed weaknesses in implementing strategic portfolio measures once they have been decided on: hardly any executives said that they implement these measures consistently and in good time. These findings outline both a cognitive gap – a mismatch between beliefs and actions – and an implementation gap – measures are not implemented properly, possibly caused by limited resources, lack of leadership or inertia.

Although awareness exists about the approaches that are needed, executives still tend to shy away from change in practice and continue to apply strategic approaches and measures that they are familiar with. Volatile market developments, however, require bold strategic moves and confident leaders who won't shy away from tackling corporate inertia to take essential measures.

Deliberately creating and utilising windows of opportunity and making use of favourable conditions instead of waiting for that once-in-a-lifetime moment are essential for success in modern markets. It is also vital that

executives promote flexible forward planning during good times instead of reacting under pressure when VUCA strikes, and that they accept VUCA and the associated need for structural investments rather than hoping for a return to the old days of stable market conditions.

In the long term, it is likely that VUCA will remain challenging on two fronts: properly accepting the characteristics and trends of VUCA markets on the cognitive side, and choosing and consistently implementing measures on the implementation side. Executives who can meet both of these challenges will be able to exploit the opportunities provided by a VUCA environment and protect the competitive positioning of their companies. Bold leadership and the courage to make transformative changes in uncertain times will yield significant returns and serve as a key enabler for continued success. ■



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# Driving value in M&A

Aymen Mahmoud & Mark Fine,  
McDermott, Will & Emery Rechtsanwälte Steuerberater LLP

▶ In recent years, global events have driven macroeconomics to be increasingly difficult to predict. This has led to analysts, investors and other market participants to question fundamentals through all aspects of investing but also to try to develop and articulate methods for maximising value.

As with any such historic period of unpredictability, market volatility can result in financial difficulty for some players, but also provide significant opportunity elsewhere. This article will consider some of the considerations within the value chain as well as the types of opportunity that may represent value as time goes on. It is important to understand the dynamics that create the current environment, and how they have impacted and will continue to impact markets.

Private equity and credit have enjoyed a stellar few years in terms of transacting and raising new capital and in the process, defying much of the fallout that impacted global economies during the Covid-19 pandemic. However, private equity houses now face a set of challenges not seen since the Global Financial Crisis as they deal with rising interest rates, dislocated capital markets and geopolitical uncertainty as well as supply chain shortages, valuation fears and inflation. As well as usual key investment thesis questions, the geopolitical factors currently at play also need careful consideration when considering investments.

One of the key differences seen over the past couple of turbulent years compared to those of 2008-2010 has been the availability of liquidity and its many and varied impacts on the market, including most notably, the ease of transacting. Investment data company, Preqin, considers there to have been USD 63.2 billion of private credit raised in 2021 alone (compared to USD 51.5 billion in 2020). With an absence of liquidity being a real source of consternation for the markets (and therefore for growth) during the global financial crisis of 2008, the contrast of the last few years is stark.

Committed, unallocated capital or “dry powder” can be found both in equity and credit markets, as well as in

the form of economic intervention from governments and supra-national institutions, whether by way of Covid-19 reliefs or incentives or through quantitative easing (QE, a monetary policy whereby a central bank purchases (among other items) existing government bonds to restore liquidity in the financial system). This very liquid market has manifested its impact in various ways.

Buoyant liquidity has provided private equity with easy access to the credit markets. In both leveraged buyouts and refinancings credit funds are increasingly competing for, and winning, market share against traditional underwriting banks. As seen during the ongoing uncertainty of 2022, private credit has been seen as an increasingly attractive option for many PE houses who are willing to pay a slight premium to guarantee a deal with requisite leverage, no flex and avoiding hung syndications. Where the public markets have faltered, private credit has been able to step in and help sponsors out with financing their buy outs, whether offering a complete capital solution or changing the capital structure to provide a junior debt instrument or a quasi-equity investment.

These liquid markets have also allowed sponsors to refinance what might, during less liquid times, be seen as over-levered and which may not have easily attracted new money for a financial sponsor or company director. It has allowed buyout houses to explore new opportunities in non-traditional sectors such as pre-EBITDA technologies and renewables.

Where there has been more dry powder available as a relative matter, a greater number of private equity investors have been competing for a smaller number of assets, driving valuation multiples higher.

None of these consequences of markets with deep pockets is much of a secret, yet the impact of them draws a range of views, both academic and practical. Some consider that the markets may have become more reckless, while others have suggested the markets have been forced to become more efficient.

As market uncertainty continues, it is clear that the credit markets have become more cautious (through increased pricing and reduced leverage levels) with knock-on effects for equity investors who were able to maximise their own value and returns by utilising cheap debt. Whilst market dislocation continues there will be a number of opportunities that will present themselves in a non-traditional private equity manner.

Sponsors who believe in a quick return to liquidity, a short-lived recession and/or the fixing of global supply chain issues, may have opportunities to acquire assets at depressed valuations. What is less clear is how quickly such window of opportunity will remain open and on what timeline, should market participants look to drive value. This challenging market can provide opportunities, especially as consumers change their behavior and support growth in new industries such as clean-tech, food-tech and renewables as outlined below. This shift is providing more space in the market for impact or thematic funds to operate. At present opportunities may be somewhat crystal ball gazing, and whilst all investors will have opinions as to how the markets will play out, there are plenty of present day concerns and this has resulted in decreased transaction volumes.

Alongside this highly liquid market, the world witnessed the most impactful pandemic of recent times in Covid-19. With consequences running well into 2022 for many nations, and punctuated by a range of fiscal actualities to counteract closed businesses and inactive workforces, it became increasingly clear during 2020 that the full impact of the pandemic from an economic perspective would not be known until some years later.

There was huge financial cost to governments in providing loans and other support schemes e.g., furlough schemes, all with significantly depleted tax coffers and at the same time, central banks continued to stimulate the economy. Fundamental economic theory pointed to inflation as the pandemic took real hold through the end of 2020 despite many commentators saying that their expectations on inflation were very limited. Then followed 2021, and, by many metrics, the most active market in the last ten years.

The bearish voice was therefore quietened (or at least less heard). Firms of all kinds invested in distressed investment professionals, but the performing markets, liquidity and slow run-off of fiscal intervention continued to support active markets in the first part of 2022. It was almost as though the world was slightly short of the perfect storm required to allow the distressed markets to flourish, even with supply chain issues further weakening economic activity.

Perhaps the final piece of the jigsaw needed to slow things down took more of a geopolitical form. While perhaps a pandemic is hard to prevent, armed conflict is arguably more of a “choice”.

The declaration of armed conflict in Ukraine carried with it several adjunct consequences — some more predictable than others (e.g. oil and commodity prices being driven higher and supply chains being further disrupted) but also less ostensible impacts, for example, the impacts on grain exports which has driven food prices higher.

For the purposes of this article, it is important to note that not one of these factors is singularly responsible for where we are today, or what happens next.

Where are we today? Certainly the liquidity in the markets is being deployed in a more cautious and restrained manner. Equity prices have seen some downward adjustment over the last twelve months, some of which has been significant.

The huge asset class of private credit can be seen to be marginally more restrained or a little more expensive, or both.

Interest rate rises have made corporate borrowers mindful of extending themselves in leverage terms and there is a large increase in the number of conversations being had around stressed or distressed credits. This compounding effect has been meaningful and the length of compounding is very likely to inform how the market responds in all aspects of driving value.

What strategies, behaviours and other tactics are then proving most instrumental in creating and maximising value. There are likely some more structural characteristics at play here in terms of the usual origination of deals as well as the use of thoughtful and creative interplay between ownership and growth. In particular, one asset class that has seen one of the more sustained and noticeable increases in its valuation is that of technology. It is a common feature of early-stage companies that they require significant expenditure and even with significant revenues, profitability can have a lengthy horizon. However, the continued investment from venture capital, private equity and other asset managers (whether from a growth or a control standpoint) has meant that lenders are seeking solutions to finance pre-EBITDA businesses, to help develop relationships with those borrowing counterparts. Such assets are proving attractive and seem to be withstanding the recent economic and geopolitical storm. Fitch recently commented that the technology and business services sectors have relatively low portions of issuers in the high-risk categories for interest coverage, lever- ▶▶

age and near-term maturities. Whilst this has been the case in the last couple of years, it is clear that the equity markets have seen something of a correction for tech-related stock, suggesting that the valuations that existed were simply too high and unsustainable. It may well be that there is some truth here, or that the markets more generally are overvaluing public stocks, or there may be something of a more emotional reaction driving this as can be the case in public markets.

The pure weight of capital provides a very strong base for creative and opportunist thinking. One way of doing this is to combine scale with the ability to utilise pockets of capital that can invest in both debt and equity, giving an investor the ability to participate in both parts of the capital structure. For borrowers, allowing lenders to access their equity also helps to align interests in creating upside, while also unlocking what has historically been very cheap debt capital. For lenders trying to unlock higher returns, this type of investment creates a platform to deepen relationships with borrowers without significant additional work and provides greater information about the underlying credit, all while providing those higher returns in an otherwise competitive debt market.

Asset managers around the world are now invested across capital structures through other vehicles, such as private credit or private equity. It is not inconceivable that there may come a time where an LP is an equity and a debt investor in the same asset, where creating value for one necessitates removing value from the other. In these instances, it will be interesting to see if the LP community behaves any differently, or otherwise tries to inform the behaviour of the platform managing the investment for that LP despite the potential for conflicts of interest.

Many PE sponsors have recently turned to “take private” (P2P) transactions during which publicly listed businesses are purchased, de-listed and driven through periods of growth ahead of secondary, or tertiary buy-outs. They allow private equity firms to look for real opportunities to make large scale investments (most public companies are well-capitalised and of a requisite size) and implement whole hosts of savings and synergies that drive efficiency and help maximize value. These have become increasingly popular in the last two years.

In addition, for very large, listed corporates, looking for under-performing segments of their business and divesting of those usually provides a jump in share price – many private equity institutions look for these corporate carve-outs where they are not of the size required to undertake large-scale P2Ps. For these non-core segments, there are often inefficiencies that

private equity institutions are familiar with and for which they have significant skill and resource in turnaround.

For those investors with access to huge sums of capital, the market will continue to provide opportunity, if for no other reason than the scale of opportunity which is limited to only a few players. For others, the belief that a return to more basic product types will yield significant returns will be tested in the coming months – will food businesses and planting regenerate significant business interest in an inflationary environment? Will ESG and other environmental considerations play a very large part in investment thesis? Time will tell, but what is clear is that wages, inflation, cashflow, raw material cost, supply chain and geopolitics can combine to cause tremendous volatility in valuations. That volatility can create as much opportunity as it can cause fracture – it is for the participants who have shown so much creativity in the past – to remain flexible, thoughtful and exploratory in evaluating great and new opportunities for growth.

In a world where so many investments were judged on their historic and look-forward statistical matrices, we may now see a greater focus on liquidity, margin and the ability to “stay alive” during the hard times.

Whilst simplistic, the approach of maximising gains is only one half of driving value. The other half is softening any losses, and this aspect may well be influential in the value chain in the coming years. After all, if one wants to consider how to maximise value, one must first accept that all value is relative. ■



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# Carve-outs in a disruptive environment – disruption as a driver of economic change processes

Dr. Rainer Bizenberger, Birte Stamm & Manuel Szerencses, AlixPartners

▶ 96% of the German executives surveyed as part of the AlixPartners Disruption Index 2022 say their business models must change within the next 3 years, 60% already observe a transformation or expect it to happen within one year<sup>1</sup>.

This expectation is driven in particular by developments such as further accelerated technological change, breaks and disruptions of supply chains, fragile economic growth with rising inflation rates, and new ESG regulations. The war in Ukraine is a further external shock to which companies need to respond to in the short term, and we can expect additional disruptions in the coming years.

<sup>1</sup> AlixPartners Disruption Index 2022 – Taking control in a disrupted world 2022: <https://disruption.alixpartners.com/>

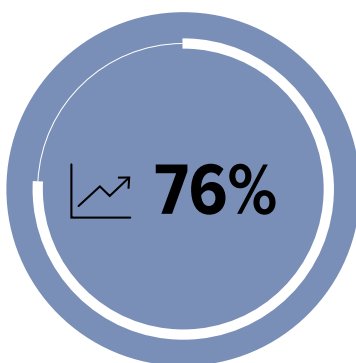
To effectively respond to strong disruptive forces, organizations must continually adapt to changing circumstances, prioritize activities and bundle resources. The results of these adjustment processes can be changes in organizational structures, but in many cases a comprehensive transformation of existing business models will have to be implemented.

## 1. Carve-out as one possible response to disruptive changes

Far-reaching options for action are needed for business divisions severely affected by disruption – in extreme cases this disruption will result in the dissolution of the existing business model. ▶▶

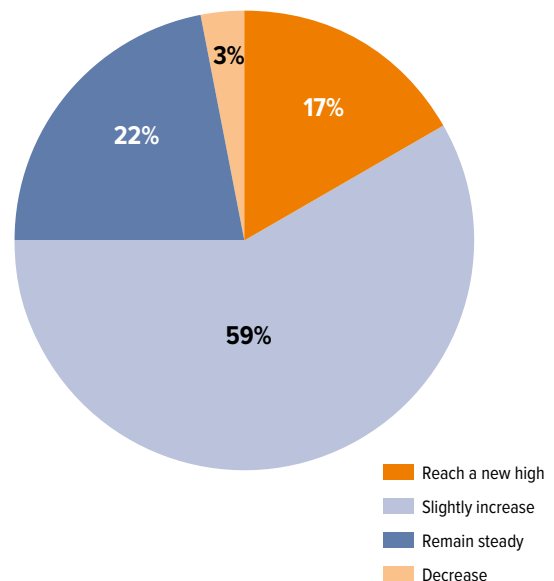
**Fig. 1 • Believe that M&A transactions related to distressed assets will increase**

Source: AlixPartners illustration



**Fig. 2 • The number of Merger & Acquisitions transactions related to distressed assets will:**

Source: AlixPartners illustration



One possible reaction to disruptive changes can be the spin-off and subsequent sale of an affected business unit, or the collaboration with a joint venture partner. In extreme cases, a wind-down or sunseting via a structured value-optimizing ramp-down might be the only viable solution to appropriately react to the situation. Indeed, 76% of the German respondents to AlixPartners' recently released Turnaround and Transformation Survey believe that M&A transactions related to distressed assets will increase<sup>2</sup>.

Since affected businesses are usually heavily interlinked with other divisions, a separation by means of an operational and financial carve-out is usually required. A separation should also be carried out to protect the "healthy" assets of a company from deteriorating values resulting from disruptions in other areas (so-called "ring-fencing").

## 2. Critical success factors for a carve-out in a disruptive environment

Every carve-out project has its own rules and particularities which need to be considered during implementation. However, there are certain playbooks that can be applied – slightly adapted for each project – to facilitate the implementation. Careful planning and the strict implementation of defined goals are essential for a successful realization of a carve-out project.

The definition of a clear target, i.e. the strategic, operational and financial goals of the envisaged carve-out, is of crucial importance if working under disruptive conditions. Only with a clearly defined target all parameters and options can be properly evaluated, and decisions made at all times during the execution phase.

In a disruptive environment, the preparation and implementation of a carve-out means, above all, "working under uncertainty" – and in most cases very tight schedules need to be met. As a result, strict adherence to standardized project manuals is rather detrimental, as planning parameters and risk profiles under which the carve-out is designed and implemented are subject to constant change.

The following five key success factors are crucial for the implementation of a carve-out in a disruptive environment:

### 2.1 Clear definition of the carve-out scope and evaluation of all implications

- A comprehensive clarification of the carve-out scope is crucial for ring-fencing healthy assets.
- To clearly define the scope, affected assets and liabilities must be identified at an early stage and solutions for so-called hybrid locations must be developed (locations that comprise several different business units – their operational separation from one another is usually very complex).
- After clarifying the allocation of the assets, a detailed target structure needs to be developed, reflecting the effects of a new organizational and legal set-up. This approach prevents time-consuming changes at a later stage.

### 2.2 Planning with scenarios and maximum flexibility

- The development of planning scenarios helps to create a more robust basis for the carve-out project, so that decisions can be made considering all parameters.
- The developed scenarios ensure flexibility in the further course of the project, and rapid responses to changes in framework parameters are possible. This pertains to both, adjustments to the operational implementation of the carve-out and the selection and implementation of exit scenarios. For example, selected exit scenarios may no longer be valid after some time – planned sales processes can be aborted due to a lack of interest from potential buyers meaning a scenario of a wind-down may need to be implemented instead.

### 2.3 Implementation with focus and pragmatism

- As carve-outs characterized by disruption have to be implemented under time pressure and significant changes can occur at any time, the project team must ensure a "can-do/will-do" attitude. In addition, decisions need to be made without adhering to complex decision-making processes.
- Speed of implementation must be prioritized over perfection.
- An "80/20 mind-set" is essential to avoid time-consuming analyses and discussions, enabling quick decisions and rapid implementation successes.

<sup>2</sup> AlixPartners 17th Annual Turnaround and Transformation Survey: <https://features.alixpartners.com/storm/index.html>

## 2.4 Less is more – small teams with experienced carve-out experts

- In a disruptive environment, complex carve-outs do not benefit from oversized project teams with countless project modules.
- The key to success is a core team of experienced “doers” who lead the project to success despite all the uncertainties.
- An experienced core team and the optimal composition of its members form the bracket around all other success factors and pave the way for a successful implementation of the carve-out.

## 2.5 Change management and communication

- A carve-out under disruptive conditions is always associated with major upheaval and uncertainty among affected employees.
- Continuous employee communication helps to motivate those affected during a complex implementation phase.
- Well-planned and implemented customer and supplier communication support the business transformation of the carve-out.

## 3. Conclusion

In a disruptive environment, nothing must be left to chance for a successful implementation of a carve-out strategy, since planning and implementation are exe-

cuted in an environment of persistent uncertainty. Enablers of a successful carve-out are small, experienced carve-out teams, who can react quickly to changing parameters and manage the carve-out project safely and reliably through disruption. ■



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# Implications of the UK's National Security and Investment Act 2021

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## 1. Overview of the NSI Act

▶ Any investor (wherever based) that is proposing to invest in a “qualifying entity” or “qualifying asset” will need to take into account the UK's NSI Act which came into force on 4th January 2022. The NSI Act was designed to give the UK government the ability to assess the national security implications of a broad range of acquisitions, investments, and other transactions.

Under the NSI Act, the UK government has the authority to call in and investigate so-called “trigger events” in relation to any “qualifying entity” or a “qualifying asset”. While the NSI Act lists seventeen sectors where the UK government considers a transaction may give rise to a national risk, transactions in closely related sectors can also be called in. Whether the “trigger event” is in contemplation, in progress or completed, if any party would acquire or has acquired “control” (as defined in the NSI Act) does not impact the ability of the newly established investment security unit to review the transaction. The NSI Act defines “**trigger events**” broadly to cover transactions in which one party:

- acquires or increases its interest in a “qualifying entity” so that it crosses any of the 25%, 50%, or 75% thresholds in relation to share or voting rights;
- acquires voting rights in a “qualifying entity” that enables that party to secure or prevent the passage of any class of resolution governing the affairs of a “qualifying entity” (i.e. control);
- obtains “material influence” over a “qualifying entity”; or

- acquires specified control rights over a “qualifying asset” (i.e. providing the ability to: use the asset, or use it to a greater extent than prior to the acquisition; or direct or control how the asset is used, or direct or control how the asset is used to a greater extent than prior to the acquisition).

A “**qualifying entity**” is any entity (other than an individual), whether or not a legal person and therefore includes (but is not limited to) companies, limited liability partnerships and any other bodies corporate, partnerships, unincorporated associations and trusts. It should be noted that entities that are formed or recognised outside the UK are capable of constituting a “qualifying entity” if they carry on activities in the UK, or supply goods or services to persons in the UK.

“**Qualifying assets**” comprise land, tangible (or, in Scotland, corporeal) moveable property, IP and ideas, information or techniques which have industrial, commercial or other economic value, and which are used in connection with either activities carried on in the UK, or the supply of goods or services to persons in the UK. It should be noted that land or moveable property located outside the UK will be a “qualifying asset” provided that it is used in connection with activities carried on in the UK, or the supply of goods or services to persons in the UK.

The NSI Act therefore captures not only transactions in the UK between UK companies, but also acquisitions outside the UK for example if a non UK company acquires a UK company or a company with a UK subsidiary or a company that “carries on activities” or “supplies goods or services” in the UK. Non UK assets

are also caught if used in connection with UK activity, so for instance the acquisition of non UK machinery used to produce equipment to be used in the UK, or the acquisition say of an offshore wind farm in France used to generate electricity supplied to the UK.

If any “trigger event” occurs involving “qualifying entities” operating in any of 17 designated “high risk” sectors (so-called “notifiable acquisitions”), then the acquirer or acquirers must i) first notify the UK’s Department for Business, Energy, and Industrial Strategy (“BEIS”) of the “trigger event” and ii) obtain clearance before the “trigger event” is completed. The consummation of a “notifiable acquisition” without notification and getting such clearance results in the transaction being legally void. In addition, the breaching acquirer in such transactions could face civil fines or even criminal penalties as follows:

**Fines:** Completing a notifiable acquisition without approval: the higher of 5% of the total value of the business’ turnover and GBP 10 million;

Failing to comply with an interim or final order: the higher of 5% of the total value of the business’ turnover and GBP 10 million plus a daily rate penalty which is the higher of 0.1% of total turnover and GBP 200,000;

Failing to comply with an information notice or attendance order, and various associated offences: GBP 30,000 plus a daily rate penalty of GBP 15,000; and/or

**Imprisonment:** 1 to 5 years for officer of the company, if attributable to their consent, connivance or their neglect.

The designated “high risk” sectors involved are as follows: Advanced Materials, Advanced Robotics, Artificial Intelligence, Civil nuclear, Communications, Computing hardware, Critical suppliers to government, Cryptographic authentication, Data infrastructure, Defence, Energy, Military/dual use technologies, Quantum technologies, Satellite and space technologies, Suppliers to the emergency services, Synthetic biology and Transport.

## 2. What has been the impact so far of the NSI Act?

Apart from one blocked transaction so far and a small percentage of transactions being called in for further scrutiny (see later for further details), the main impact so far has been the additional costs for investors in assessing whether or not an investment falls within the NSI Act, the costs of making a filing if it does or if a voluntary filing is advised, and the added degree of uncertainty around getting a clearance.

The main impact so far has been the additional costs for investors in assessing whether or not an investment falls within the NSI Act, the costs of making a filing if it does or if a voluntary filing is advised, and the added degree of uncertainty around getting a clearance. In addition, there are costs associated with having to provide for such a filing in the relevant subscription or purchase agreement, plus the potential delay to deal completion. An unquantified factor is the chilling effect that such legislation may have on “would be” investors in deciding whether or not to invest in qualifying entities or qualifying assets.

As regards the uncertainty and timing factor, on 16th June 2022, BEIS published its first “annual” report regarding the NSI Act along with a Memorandum of Understanding (“MoU”) between BEIS and the Competition and Markets Authority (the “CMA”) on the operation of the NSI Act. The report covers the period from inception of the NSI Act to 31st March 2022, and provides some useful statistics regarding notifications that parties have filed pursuant to the NSI Act, and the time and manner in which BEIS has dealt with such submissions, which may help allay perhaps investor fears on whether clearance will be given at least with the current UK government and in a timely manner.

Before the NSI Act came into force, BEIS estimated that there would be between 1,000 and 1,830 notifications each year. During the first three months of 2022, there were 222 notifications, which appears to be consistent with the BEIS estimates as the first quarter isn’t typically the busiest for M&A, and with the recent slowdown in M&A activity since the start of the year, it seems likely that the filings will be at the bottom of that range for 2022.

BEIS has taken an average of four working days to accept mandatory submissions and five working days to accept voluntary submissions. Where BEIS has decided to call-in a trigger event for review, it has taken 24 working days on average to issue call-in notices for mandatory notifications and 22 working days to issue call-in notices for voluntary notifications. BEIS has not though published statistics regarding the average time it has taken to clear notifications that are not subject to call-in notices.

Of the 222 notifications submitted between 4th January 2022 and 31st March 2022, 196 were mandatory notifications and 25 were voluntary notifications and only 1 notification sought retrospective validation of a completed trigger event.

Since the NSI Act came into force, BEIS has called in 17 trigger events for a full national security assessment, with 13 of these being mandatory notifications and

3 voluntary notifications. Of the 17 called in, BEIS has (to date) issued final clearance notifications on 3 of them without imposing any conditions on the parties. BEIS took an average of 24 working days between calling in a trigger event and issuing a final notification for these transactions.

While as a matter of course call-in notices will not be made public, BEIS announced on 25th and 26th May respectively that it was reviewing Nexperia (a Chinese backed company)'s acquisition of Newport Wafer Fab where a decision is still awaited, and the acquisition by Altice of 6% of shares in BT.

The remaining 14 called-in notifications remained under review as of March 31, 2022. To date, we are only aware of BEIS issuing one final order blocking a trigger event from completing which was in fact in relation to a voluntary notification as opposed to a mandatory notification. BEIS announced on 20th July that it had blocked Beijing Infinite Vision Technology (BIVT) from buying the vision sensing IP technology from the University of Manchester. For completeness, we are not aware of any order under the NSI Act to date requiring the parties to undertake mitigation measures prior to completion. BEIS has called in fewer than 10% of all notified transactions during the first quarter, which is within the ballpark estimated by BEIS of between 70 and 95 trigger events each year.

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The sectors of the economy from which most mandatory notifications were received were Defence, Military and Dual Use, and Critical Suppliers to Government. Voluntary notifications were most commonly received from acquisitions where the target was active in Professional, Scientific and Technical Activities, and Data Infrastructure.

As regards the MoU between BEIS and the CMA, this sets out the legal framework and broad principles for collaboration on the timing of investigations, interim measures, remedies and the sharing of relevant information between the two authorities, which should help each other's review. Examples of information that

may be exchanged between the two authorities include:

- information on current or historical CMA cases;
- information the CMA may hold on competition within a given sector; and
- notifications of when the Secretary of State intends to impose remedies or accept undertakings as part of a NSI review.

Parties submitting applications to the CMA and BEIS as part of any transaction should therefore make sure that the information provided to both authorities regarding the relevant transaction is consistent.

### 3. What clarifications have the UK Government made regarding the NSI Act?

BEIS has also recently published "Market Guidance Notes" on 19 July 2022 which address and clarify a variety of substantive issues related to the NSI Act.

They have clarified for example that the UK government considers that:

- the appointment of a liquidator or receiver may be a qualifying acquisition, and in specific cases may require mandatory notification. This will depend on whether and how the circumstances of the appointment meet the requirements of the NSI Act. It should be noted that the NSI Act does not treat rights that are exercisable by an administrator or by creditors while an entity is in relevant insolvency proceedings as being held by the administrator or creditors;
- the granting of types of share security where title to the shares is not transferred to the secured lender (or its nominee) is not a notifiable acquisition requiring mandatory notification, even if it involves an entity carrying on activities covered in the Notifiable Acquisition Regulations;
- internal reorganisations can be qualifying acquisitions where they result in an acquisition of control over a qualifying entity (as defined in Section 8 of the NSI Act), even if the ultimate beneficial owner of the entity remains the same;
- they are mindful of those investors seeking to exert malign influence over sensitive businesses through the use of contractual rights and, depending on

the facts of the case, that contractual rights – either alone or together with other interests or rights – give an acquirer material influence. Although, an acquisition of material influence is not subject to mandatory notification, the parties may submit a voluntary notification. Irrespective of whether a notification is submitted or not, the Secretary of State may call in qualifying acquisitions where they reasonably suspect the acquisition may give rise to a risk to national security.

Further, useful guidance is provided in the Notes on the quality of the applications that need to be made and reasons why notifications have been rejected. These include the following:

- the notification did not meet the requirements for notifications set out in the NSI Act and Regulations;
- the notification did not contain sufficient information for the Secretary of State to make a decision as to whether to call in or clear the acquisition;
- the notification was made as a mandatory notification when it should have been a voluntary notification;
- the notification was made as a mandatory notification when it should have been submitted as a retrospective validation application because the acquisition had already been completed;
- the notification did not include enough information about the acquisition or parties to it; or
- the notification covered multiple qualifying acquisitions that should instead have been submitted as two notifications. However, in rare cases the Government has pragmatically accepted a single notification to cover multiple qualifying acquisitions where these contribute to a single effect – for example, in the case of some internal group reorganisations.

#### 4. What next for the NSI Act and Conclusions?

As regards the future, the Market Guidance Notes note that the NSI Act gives the UK government power to create exemptions from the mandatory notification requirements based on the “characteristics” of the acquirer. There are currently no exemptions for any specific type of acquirers made under this power.

The UK government is though monitoring closely how the NSI Act works in practice, analysing trends and risks to determine whether it would be appropriate to make exemptions to the mandatory notification requirements. One could imagine that internal group reorganisations where there is no change to the ultimate beneficial ownership could be exempted in the future.

What is clear is that the Government is not afraid of exercising its powers to call in transactions whether in the 17 sectors or for voluntary notifications, and to exercise its powers to block transactions where it perceives a national security risk. It is comforting though to note that the one blocked transaction to date and those subject to further scrutiny represent only a very tiny minority of the notified transactions. As regards the blocked transaction, it is notable that this involved a China backed buyer and we still await the decision with regard to Newport Wafer Fab by another China backed buyer. We will continue to monitor developments and the next set of Market Guidance Notes are expected to be published by BEIS in early 2023, when we hope to get further insight into the working of BEIS in this area.

Any regulations which define exemptions to the mandatory notification system under the NSI Act would though be subject to Parliamentary scrutiny before being implemented.

The next set of Market Guidance Notes are expected to be published in early 2023. ■



**Tom Whelan** focuses his practice on private equity, advising private equity sponsors, multi strategy funds, other private capital investors and corporates, helping them deploy capital across the world. Tom handles buyouts, including secondary buy-outs and secondaries, take privates and co-investments, general M&A, bolt-ons, management incentive plans, restructurings and refinancings through to exits. During the course of any investment, Tom advises on portfolio company work and any changes to management incentive plans. Tom regularly executes transactions in regulated sectors such as healthcare, technology, media and telecoms, financial services, water and energy, as well as handling many transactions in other sectors such as real estate, hotels and leisure, food, consumer and retail, industrial and automotive.

# Democratisation of Alternatives

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► In the funds and asset management world there has been a recent flurry of activity around the so called “democratisation of alternatives”. What does that term actually mean and what is involved?

The underlying theme seems to be a perception that for too long private markets and Alternative asset classes, notably private equity, have effectively been a closed shop, with access limited to institutional investors, who with their deep pockets and ability to bear loss have been able to access returns on investments that are not generally available to individual investors, or at least at the “retail” end of the individual investor universe, as “family offices” representing ultra-high net worth individuals have for a long time invested in and co-invested alongside these funds.

That may be the case, but is the fact individuals in the mainstream can’t access this asset class surely a good thing from an investor protection standpoint? However, given the recent popularity and risk appetite for the public to invest in unregulated crypto markets which are volatile, is that not in fact riskier? Isn’t an investment in a private equity fund, where in Europe at least, the managers of those funds are subject to regulation in the form of AIFMD and the fund sponsors often regulated in their own jurisdictions and the asset class is highly mature and professionalised actually in fact a less risky and less speculative investment proposition? And if it’s good enough and safe enough for the risk appetite of institutional pension funds, then isn’t it good in terms of an investment for the general public as well (whose pensions they contribute to every month from their salary may actually be partly invested in those asset classes already in any event by the pension fund providers they entrust to look after their retirement funds)?

Leaving aside the risk profile and merits of the asset class of the investment itself, how can asset managers

who want to bring about this democratisation do this (and why would they want to) and how can individual mainstream investors invest in these alternative asset classes, like private equity, commercial real estate and infrastructure?

For it to be truly democratic then individual investors will need to invest alongside the institutional investors in the same assets, otherwise if it’s just a private equity fund that only individual investors can invest in (and it is just those investors, not institutional investors as well), then there could be a suggestion that the “good stuff” is still going to the institutional investors and the individual investors are just getting the leftovers in the market the institutional investors don’t want.

One way to achieve this is to put the individual investors on a par with the institutional ones. The key to this is aggregation. By combining the individual investors in a separate vehicle but a vehicle that is a hard wired integral part of the fund can make the individual investors and the institutional investors equal, whether it’s a parallel vehicle or a specific feeder vehicle into the main fund, that vehicle can enter into a subscription agreement and be drawdown as if it was any other institutional investor, and behind the scenes the individual investors benefit from access to the same returns on the same assets as the institutional investors. Those individual investors can even benefit from “most favoured nations” provisions, given that depending on the popularity of the fund that individual investor vehicle could be in aggregate a similar size or bigger size to an institutional investor who may have negotiated preferential terms, perhaps resulting in the individual investors sharing in the benefit of lower management fees negotiated by those larger investors but capable of election for under MFN by the individual investor aggregating vehicle – which the individual investors wouldn’t have been able otherwise to negotiate as a discount for themselves.

How can asset managers facilitate this democratisation, other than building the required fund structure? Taking advantage of the trend for a fund digital marketplace where investors can quickly and easily invest could help with this. Fund supermarkets, on the retail side, allow individual investors to quickly, and digitally, invest in funds designed for retail investors, with investor suitability checks and KYC all handled through the account opening process. There is no substantial reason similar technology cannot be applied to this use case of individual investors investing in alternative asset classes. Imagine everything being done through an app, with investors signing a subscription agreement which is completed through answering a questionnaire by ticking or selecting the appropriate answers to complete it digitally. Individual investors, suitably forewarned and digitally risk assessed could even “elect up” to be treated as professional clients under MiFID II through such a platform, and could receive all required costs and charges, investor tax reporting and drawdown requests through such a platform as well, with perhaps the latter linked to a direct debit or standing order on the investor’s designated bank account to reduce the risk of accidental unintended defaults on drawdown requests.

So what’s in it for asset managers? Well maybe from time to time in a given investment period institutional investors are in scarce supply because they have already allocated their investment capability to other funds. Mainstream individual investor investment capacity and pent-up demand can in this case provide a way to help an asset manager reach its target fund size. Or perhaps the asset manager wishes to build its private wealth offering generally and this provides a way to access a new client base. There are many rea-

sons and perhaps in the past where smaller individual investors may have been deemed too burdensome and difficult for an asset manager to access then a digital investment platform can easily help to break down that barrier for both asset manager and individual investors.

The possibilities for sponsors (in particular for first time managers who don’t have legacy funds with the resultant legacy investor base to tap for new fund raises) of allowing access to mainstream individual investors to these funds and through digital platforms are potentially significant. Whereas before a fund sponsor may have needed to team up with the wealth management division of a bank (and often with the balance of power with the bank) in order to tap the individual investor market, now it can attract these investors directly, either itself or through a platform provider. This provides fund sponsors with access to sources of investor capital that they may not have been able to access before. There are of course a number of marketing issues which need to be considered. The promotion of non-mainstream pooled investments to ordinary retail clients who are neither sophisticated investors nor high net worth individuals is currently prohibited in the UK by the FCA. Consequently, sponsors seeking to access sources of funding from individuals in the UK need to ensure that they market to them in accordance with the exemptions available under COBS 4.12.4 (restrictions on the promotion of non-mainstream pooled investments) – the certified HNW investor, certified sophisticated investor and self-certified investor exemptions likely being the most useful. It is also worth noting that an ordinary retail investor may opt to be treated as an elective professional client if they meet the relevant criteria and if so the exemption to allow promotion to non-retail clients may also be available. ▶▶

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Though investors may be electing-up to be considered as non-retail investors, what protections should these platforms offer? What needs to be disclosed to investors, how is this done and do the investors truly understand what it is they are investing in? Careful thought needs to be given to these issues when building these democratised fund products and platforms.

The terms of the aggregating vehicle and especially what happens in the case of one of their fellow aggregated investors defaulting is important. For example, under the terms of the main fund the whole aggregating vehicle would be defaulted, and if so, does everyone in the aggregating vehicle suffer the punitive default provisions that closed-ended alternative asset funds generally contain? A side letter in place with the target fund agreeing to “look through” treatment in the event of default may be a solution if the target fund agrees to this. Alternatively, drawdowns may be managed to mitigate this risk, for example investors in the aggregating vehicle being fully drawn at the level of the aggregating vehicle on day one and the funds held within the platform until called by the target fund. This then does raise the question of how those funds are held and the consequent drag on the performance of an investment made into the aggregating vehicle. Or are drawdowns “smoothed” through the use of borrowing facilities in place at commitment level as they often are where the investors are all institutional investors (and if they are, how is the borrowing base calculated)? It may also be beneficial to match the terms of the aggregating vehicle as closely as possible to that of the main fund e.g. stating in the constitutional documents of the aggregating vehicle that the terms of the main fund apply only changed as they need to be (other than where they specifically need to be different as a result of tailoring for the aggregating vehicle).

In the private wealth world, particularly on the high net worth side, aggregating vehicles have been used previously by banks often working alongside the relevant fund sponsor to give their high net worth clients access to alternatives funds. Now there also seems to be a concerted regulatory recognition, broadening access to alternative investments could be a good thing. In the UK for example the FCA in August 2022 opened a consultation: “CP22/14: Broadening retail access to the long-term asset fund for marketing long term assets funds to include retail investors”. The consultation is centered on the use of the Long-Term Asset Fund (LTAF) (a new category of UK authorised open-ended fund). LTAFs have been designed to enable investors to invest in long-term illiquid assets through an authorised fund vehicle. Such long term asset funds may be particularly suited to infrastructure funds, especially timely when the economy is faced with long

term challenges of creating methods of alternative energy supply, including renewables, and the long term nature of such funds aligns more closely with the long term nature of investment required for infrastructure, which often a traditional ten year life closed-ended fund with a five year investment period often doesn’t neatly correlate to. Accessing retail markets (in a regulated way) to support such investment alongside institutional investors may therefore make sense from a political, regulatory and investment standpoint, whilst perhaps giving retail investors a long term higher rate of return derived from long term assets (and provided they can bear the risk of such investments), and which may make more sense from a risk/reward perspective than cash on deposit in an inflationary environment. In broadening the access to LTAFs to include restricted retail investors the FCA have stated in the consultation that they intend to reclassify a unit in an LTAF as a Restricted Mass Market Investment and the FCA also note that “An ability to invest in long-term illiquid assets, through appropriately designed and managed investment vehicles, is also important to supporting economic growth and the transition to a lowcarbon economy.”<sup>1</sup>

When opening access to alternatives to mainstream investors the regulatory position of these platforms and funds, their manager and investor protections are crucial, as well as ensuring the risks are properly explained to investors and disclosed. But perhaps with consultations such as those announced by the FCA then this investment environment and previously closed shop access to alternative investments may soon become more democratic. ■

<sup>1</sup> FCA: “CP22/14: Broadening retail access to the long-term asset fund for marketing long term assets funds to include retail investors”



**Steven Haywood** focuses his practice on private investment funds and alternatives asset management. He has extensive experience in advising Alternative asset managers on the structuring, establishment and operation of private investment funds across alternative asset classes, including private credit and direct lending funds, private equity and private equity secondaries, infrastructure and real estate funds, as well as advising institutional investors on primary and secondary fund investments and on co-investments. Prior to joining McDermott, Steven worked for a multinational professional services firm as the lead lawyer for private investment funds in their UK financial services law team. He also has a magic circle, international and offshore law firm background. In addition, Steven has significant in-house legal industry experience gained within alternatives asset management divisions of a multinational investment bank and a multinational insurance company giving him both adviser and client perspectives.

# ESG and private equity: How integrating ESG fast and efficiently can boost transparency for both General and Limited partners

Marcus Höfer, base camp management consulting

► Sustainability is becoming more important for corporate governance and investments all the time. Yet sometimes the private equity industry still lacks clear strategies for introducing and implementing sustainability. But an ESG Performance Monitoring Framework can be used to manage improvement efforts both at the fund level and in portfolio companies.

More and more companies are treating environmentally conscious, socially aware conduct as a relevant management goal and integrating it in their corporate strategies. After all, allowing for environmental, social and governance (ESG) criteria is something both society and regulators are now coming to expect. And those criteria also offer measurable economic potential. It's true that national legislators and the European Union have taken their first specific steps toward setting uniform requirements for sustainability and social responsibility for financial investors (such as the Taxonomy Regulation, the SFDR, the CSRD). But the associated contents and details have not been worked out far enough yet for us to be able to speak of a global (or at least EU-wide) reporting standard for investment managers. All the same, many private equity investment managers are looking very hard at the topic right now. With no complete legal framework available, a broad variety of voluntarily based approaches to an ESG commitment and reporting have evolved, especially in the past few years. The pressure on private equity firms comes directly from greater demand. Limited partners in particular are proving to be the driving force in boosting the significance of ESG for private equity, and that effect is going to continue to increase sharply. As the

details of legal framework become more firmly established, existing ESG reporting is likely to harmonize rapidly in the near future, and the last fund managers who were wavering about ESG can soon be expected to start cooperating and make a commitment.

ESG generally used to be viewed as a niche topic for dedicated investors. But now it's becoming a market standard. That is clearly evident from investors' soaring interest, the public attention given to sustainability, and the ongoing effort to develop uniform ESG reporting standards within the EU. Private equity funds can profit from this megatrend, which is why they should pursue a comprehensive ESG strategy even in spite of the associated expense.

## 1. ESG must be integrated into the entire fund life cycle

Depending on a fund's intended engagement and strategic focus, it's important to define principles, criteria and goals clearly. Several questions must be answered before one tries to develop and implement an ESG strategy:

- How will the fund's ESG goals be reconciled with corporate strategy and enterprise values?
- What is the current status for implementing the ESG strategy?
- What will be needed to achieve the adopted ESG goals?

It's crucial for a comprehensive ESG strategy at the fund level to be integrated across the entire fund life cycle. So as a first step, it's important at the deal sourcing level to ensure that screening frameworks are applied that take conformity to the fund's sustainability goals into account. During the subsequent due diligence, the fund strategy plays a key role as a standard for a full ESG assessment of target companies, and as a starting point for defining ESG value levers as part of a value creation program.

But when introducing an ESG investment strategy in portfolio management, it becomes especially complicated to reflect ESG-compliant corporate goals uniformly and monitor them consistently. The mere question of data availability and quality at the portfolio level, along with gathering, processing and analyzing the data, generally becomes an obstacle on the path to fund-wide ESG reporting. If you want to map historical developments and benchmark best practices, you must thus have at least a partially automated ESG management platform for the portfolio companies. Our clients (general partners) use our ESG Performance Monitoring Framework for this purpose. It unifies software-based and platform-based data from the general partner's portfolio companies in a structured, standardized way.

Finally, each ESG program will also bear fruit in the end. To realize generated ESG value in a successful exit process, the improvements must be convincing. What counts most of all here is an appropriate communication strategy and disclosure of value potential compared to the peer group.

## 2. Each general partner's ESG strategy should be based on the UN's 17 Sustainable Development Goals.

Each general partner's core investment principles will always serve as the basis for defining an ESG strategy at the fund level. These internal guidelines for aspects like the environment, society and corporate governance, and for compliant investment conduct, should be set up in line with the UN's 17 Sustainable Development Goals. The UN goals are now universally acknowledged in the industry, and private equity fund managers, depending on their own ESG strategy, are more and more taking them into account either in full, or at least as an emphasis, in their investment and ESG strategies.

Moreover, for steering and for achieving goals, it's important to introduce fund-wide ESG reporting. This offers an opportunity to identify and realize a portfolio company's value-enhancing potential that might not otherwise be immediately evident. On top of that, reg-

ular ESG reporting can keep the general partner's investors posted about the ESG strategy and implementation successes at the portfolio companies.

## 3. Implementing and establishing transparency with the ESG Performance Monitoring Framework for general and limited partners

The ESG Performance Monitoring Framework embodies the technical and professional requirements for ESG reporting:

- It develops a benchmark-based ESG Rating that establishes comparability across the various industries of the general partner's portfolio companies.
- It provides monitoring of the key figures defined in the ESG Rating, such as share of renewable energy in power consumption, employee diversity at the management level, and implementation of explicit governance policies.
- It implements a standardized, automated software platform that minimizes the effort of collecting, processing and analyzing data for both portfolio companies and the general partner, and makes it possible to focus on interpreting information and on follow-up measures.
- It provides regular reporting of fund-wide ESG development to limited partners.
- It incentivizes management teams of portfolio companies by way of ESG-relevant drivers.

To produce the ESG Performance Monitoring Framework, base camp has developed a Business Intelligence Reporting system in combination with an online tool. This solution harmonizes the portfolio companies' various databases so that all key figures and their evolution can be displayed, compared and analyzed at both the company and fund level.

The following reports are the results of a GP Reporting process for the whole portfolio. Here we show extracts of information for all sorts of Environmental und Social aspects:

- Carbon Footprint: CO<sub>2</sub> emissions, etc., by energy source and type, along with CO<sub>2</sub> offsets
- Social: Numbers of employees, including by contract type and length of time with company, together with analyses of staff turnover and absenteeism.

Fig. 1 • Fund ESG Reporting: Carbon Footprint

Source: base camp

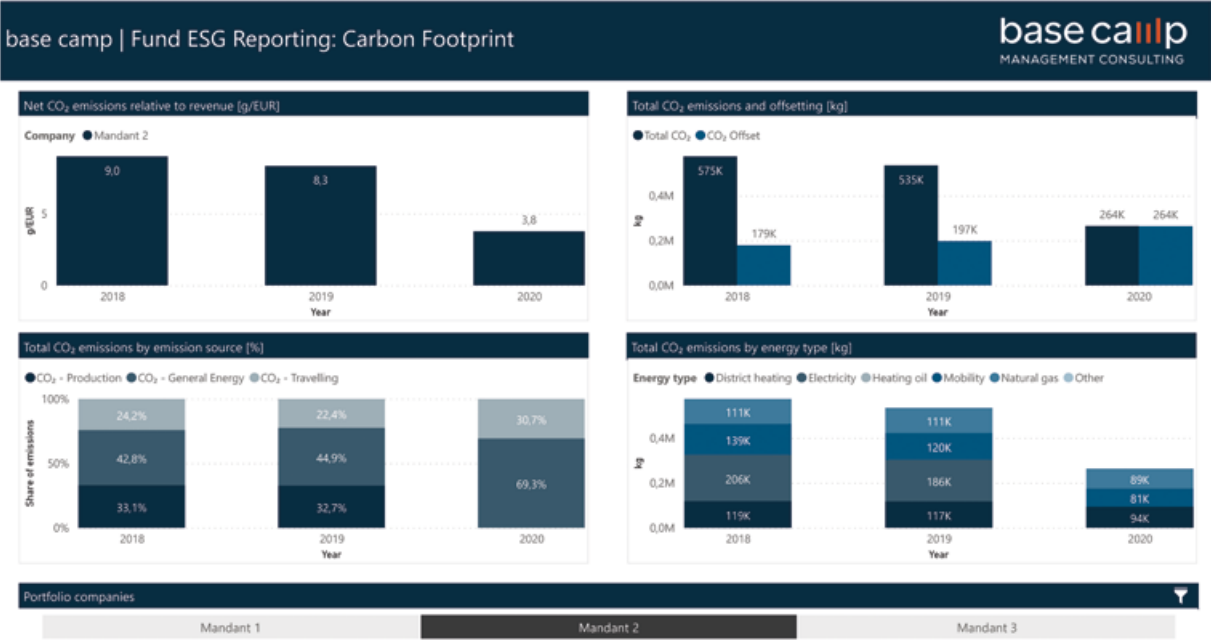


Fig. 2 • Fund ESG Reporting: Social-General

Source: base camp



\*Illness Rate = share of illness days of 220 working days (1 FTE) per year

**4. Value creation and long-term management of the portfolio are the key to sustainable investments**

Based on the ESG Performance Monitoring Framework, first the historically available data from the portfolio companies are gathered and integrated in a standardized form for analysis. In the next step, sustainability goals are formulated, based on industry comparisons, and are coordinated between the portfolio companies' management teams and the investment teams in charge. Measures for improvement can be identified on that basis and initiatives can be developed, such as:

- Environmental: Rapid switch to remote work and replacing air travel with rail travel, to reduce the carbon footprint
- Social: Establish a task force to promote employee diversity company-wide, and measure employee satisfaction
- Governance: Expand fund-wide guidelines for compliance and corporate governance at portfolio companies

How well each portfolio company attains ESG goals will now be measured on the basis of its ESG Rating, and its ESG performance will be tracked over the long term.

Developing a strategy, and integrating the ESG Performance Monitoring Framework on that basis, can serve to steer ESG-compliant corporate governance within the fund. This ensures that all companies in the portfolio improve steadily on the basis of relevant, measurable criteria. This benefits both the portfolio company and the financial investor. ■



**Marcus Höfer** is the CEO of base camp. From his years of working with multiple private equity funds and their portfolio companies, he has many years of experience in management consulting, and has played a major role in various international and national digitalization projects and transformations. As an early adopter of new technologies and a "digital native," he is an ideal contact person for all aspects of digitalization for companies who want to venture into this important step. Marcus Höfer holds a Master of Science Information Systems from Technical University Munich, with a major in Corporate Finance.

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# Intelligent private company data, supporting the M&A target sourcing process



► An effective deal sourcing process has become more important than ever when trying to find attractive investment targets within the private company arena in the DACH region and all over Europe. Strategy, Private Equity and M&A have become increasingly data-driven and structured in the deal sourcing process.

Being the market leader in Nordic private company intelligence, Valu8 Company Intelligence has been expanding within the DACH region since 2019, disrupting the existing company data solutions with a combination of structured and unstructured company data for company sourcing.

Our deal sourcing platform covers detailed data of more than 70 million European private companies, helping our clients to quickly access relevant information, ranging from industry analysis down to company details, financial data, group structures, ownership data, key people and peoples' networks.

Valu8 sees the M&A driven, private company data landscape, simplified, as a pyramid. In Germany, as for most European countries, statutory reported structured data can be retrieved at Bundesanzeiger and other public registries. Statutory structured data forms the base with tens of millions of companies, effectively all registered legal entities within a region.

New technology, using machine learning and NLP (natural language processing), enables truly value-added enrichment of traditional, structured data with additional layers of normally web based, unstructured data, creating completely new ways of mapping pan-European company data. Examples of this are similarity scoring algorithms, cluster key influencers with a sector or a company sphere and blended key indicators to determine where a private company is heading on a growth line.

Enhanced data and technology for entire sectors and for millions of companies in a region, provide remarkable results. This second layer of enriched datasets becomes even more important for private companies where the availability of public statutory data is lower and public reporting is lagging in some markets by up to 24 months.



Example analysis from the Valu8 private company deal sourcing platform.

Higher in the pyramid, both technology-driven solutions as well as data analysts are used to quality check large amounts of data. For selected, value-add "edge" data for Private Equity and M&A users, we build semi-manual datasets again using both technology-driven solutions as well as data analysts. Examples are detailed ownership data and private equity focused data such as private equity portfolio company data and portfolio peer company data.

At the top of the pyramid, our platform value ends, as we see it – at this point the highly focused data analysis is rather naturally made by the Private Equity or M&A professional. To date, there is no sharper alternative than the human professional's qualitative analysis of a condensed data set in the form of a provided short list of target companies or individuals. Our mission is, ultimately, to make sure our customers do not miss out on any potential companies or targets in the screening



process due to bad data and to increase the efficiency in the sourcing process.

With close to 400 organisations using our European platform we, offer a personalised product that meets the specific needs of each user and can be customised for different industries or segments.

With backgrounds from the M&A industry, our team aims to have a pro-active approach with our users, using our customers' feedback to constantly improve our product offer over time.

Find out more at [www.valu8group.com](http://www.valu8group.com)

*"We see M&A driven data in the form of a pyramid. We add private company data intelligence and target sourcing efficiency in the first 80% of the sourcing selection process, where we make sure that the entire selection is represented, and no potential companies or targets are missed in the screening process due to bad data. The last 20% of more qualitative analysis is made by our customers."*



Anders Lundgren, Founder and CEO

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# M&A Laws and Regulations 2022

Norman Wasse & Lisa Schickling,  
McDermott Will & Emery Rechtsanwälte Steuerberater LLP

## 1. Overview

▶ In this article, we provide an overview of the German mergers and acquisitions (M&A) market in 2021, using transaction volumes and the largest deals to highlight the pertinent practical legal developments. We also offer an outlook for the rest of 2022.

## 2. Transaction volume and value

According to PwC, there were 1,206 announced deals by foreign investors involving German targets from January to mid-November 2021. By contrast, 2020 saw a total of 940. PwC said that it expected a total number of 1,380 deals for the full year 2021. The total deal volume steadily declined since a peak in 2017 (EUR 103.9 billion), amounting to a total deal volume of EUR 64.7 billion in 2019. However, since 2020, there has been an increase in deal volume. In 2021, deal volume has increased significantly. The total deal volume was expected to reach EUR 123 billion by the end of 2021, which would represent an increase of 62% compared to the year before. The average deal value in the period from January to mid-November was EUR 302 million, already exceeding the total average deal value in 2020 of EUR 265 million.

Most foreign strategic investors in German companies came from the United States, according to PwC. By mid-November 2021, US buyers totalled 265 deals and a total deal value of EUR 27.8 billion. US buyers account for 22.0% of the total amount of deals and a share of 25.9% of the total deal value. The United Kingdom came second, with 132 deals and a total deal value of EUR 3.3 billion. Next was France with 120 transactions, followed by Switzerland with 88 transactions. The number of deals in France increased by 25% from 96 deals in 2020. Switzerland is followed by the

Netherlands with 87 transactions, Sweden with 69 and China/Hong Kong with 35.

With regard to private equity deals (meaning involvement of private equity investors either on the buy or sell side), German targets attracted the most interest from US private equity investors. According to PwC, 155 transactions were completed with US private equity investors between January and mid-November 2021 (representing 29.6% of total transactions with private equity investors). The United Kingdom came second with 84 deals (representing 16.1% of total transactions with private equity investors), followed by France with 69 deals announced and Sweden with 37 deals. By comparison, in 2020, there were only 17 deals relating to Sweden, which represents an increase of 117.6%. Sweden is followed by the Netherlands with 33 deals, Switzerland with 25 deals and China/Hong Kong with 10 deals. A total of 523 deals were announced with private equity participation from January to mid-November 2021, representing a huge increase over the total of 392 transactions announced in 2020.

PwC says that out of the 30% of deals where a deal volume was published (356), only 21 represented so-called mega deals (with a deal volume of more than EUR 1 billion each and a total of EUR 70.2 billion). The largest number of deals were small transactions with a deal volume of under EUR 50 million. Here, 188 deals were announced between January and mid-November 2021, representing 52.8% of the deals. The medium-sized deals with a deal volume between EUR 50 million and EUR 250 million are also worth mentioning. Here, 109 deals were announced, which corresponds to 30.6%. Regarding transactions in which private equity investors were involved, small- and medium-sized deals were announced for the most part (84%). The number

of large deals (between EUR 250 million and EUR 1 billion) and mega deals increased by only nine from 2020 to 2021 (from 20 to 29).

According to an analysis by Ernst & Young, in 2021 there were more acquisitions made in the German private equity sector than ever before. A total of 302 transactions represents an increase of 34%. The focus was on small- and medium-sized transactions, resulting in a slight decline in the total value of acquisitions (from EUR 34.2 billion to EUR 26.2 billion). With regard to exits in 2021, Ernst & Young identified 112 deals that generated EUR 30.3 billion. In 2020, only 87 exits took place, which generated a total of EUR 16.2 billion.

### 3. Key developments

#### 3.1 Prolongation of the Act to Mitigate the Consequences of the Covid-19 Pandemic

The Act to Mitigate the Consequences of the Covid-19 pandemic under Civil, Insolvency and Criminal Procedure Law (*Gesetz zur Abmilderung der Folgen der Covid-19-Pandemie im Zivil-, Insolvenz- und Strafverfahrensrecht*) (Covid-19 Act) announced in March 2020 gives stock corporations the option of shareholders' electronic participation, absentee voting, audio and video transmission of meetings and participation by members of the supervisory board – even without a corresponding basis in the articles of association – as provided for in Section 118 of the German Stock Corporation Act (*Aktiengesetz*). For limited liability companies (*Gesellschaft mit beschränkter Haftung, GmbH*), the Covid-19 Act permits shareholder resolutions to be passed in text form or by submitting votes in writing, even without the consent of all the shareholders.

All instruments of the Covid-19 Act were limited until the end of 2020. It was initially decided to extend the Covid-19 special provisions until the end of 2021. On 7 September 2021, the provisions were extended again until the end of August 2022. The extension does not involve any changes to the content. As in the past, the decision on whether to hold a virtual or in-person annual general meeting remains at the discretion of the executive board. The latter may decide (if certain conditions are met) that the meeting is held as a virtual general meeting without the physical presence of the shareholders or their proxies. This decision requires the approval of the Supervisory Board.

At the beginning of 2022, the Federal Ministry of Justice (*Bundesministerium der Justiz*) published a draft bill providing for the introduction of virtual general meetings as a permanent regulation in the Stock

Corporation Act (*Aktiengesetz*). The Federal Ministry of Justice states that the format of the virtual shareholders' meeting has been well received and proven to work by practitioners. Virtual general meetings resulted in increasing attendance rates and an increase in the quality of responses to questions because the opportunity to ask questions in advance was implemented.

#### 3.2 Distressed M&A transactions

Many sectors have suffered during the Covid-19 pandemic (e.g. travel, sports and leisure). The massive disruption of global supply chains also had a significant impact. Despite this, the number of distressed M&A transactions did not increase significantly in 2021. According to Betriebs-Berater, the number of insolvencies in 2021 corresponded to the lowest level since the introduction of the German Insolvency Statute (*Insolvenzordnung*) in 1999. Short-time working allowances, Covid-19-specific subsidies and attractive short-term loans may have delayed some companies' need for restructuring. When Covid-19 emergency aids expire, an increase in distressed M&A transactions can be expected.

The Act on the Stabilization and Restructuring Framework for Enterprises (*Gesetz über den Stabilisierungs- und Restrukturierungsrahmen für Unternehmen*) (StaRUG), which came into force on 1 January 2021, includes the possibility of carrying out reorganizations outside German insolvency law based on a restructuring plan accepted by most creditors. If a company has not yet become insolvent, it is possible to restructure the company based on the restructuring plan against the will of any minority shareholders. Personnel measures and the unilateral termination of contracts are not possible on the basis of the StaRUG, but the use of a restructuring plan can provide security for investors in distressed M&A transactions without having to wait for the subsequent appointment of an insolvency administrator. Share and membership rights in a debtor that is a legal entity can also be structured by the restructuring plan, and arrangements permitted under corporate law can be made or shared and membership rights can be transferred. Appropriate compensation must be provided for this intervention. This option might motivate the debtor's shareholders to participate in an M&A transaction to avoid restructuring.

#### 3.3 Drafting M&A transaction documents in and after Covid-19

The challenges associated with Covid-19 are reflected in many companies' balance sheets. Changes occur particularly in areas that are decisive for determining the purchase price. To better represent any fluctua-

tions in the target's business operations, the closing accounts model for calculating the purchase price was of particular interest to buyers in 2021. Under this model, a preliminary, estimated purchase price is paid on the closing date, which is subsequently adjusted in a previously agreed balance sheet item on the basis of a closing balance sheet to be prepared at a later date. This way, any fluctuations between the last balance sheet date and the closing date can be balanced out. When applying an alternative locked box model for calculating the purchase price, extended guarantee catalogs have risen in importance. More detailed obligations regarding the conduct of the company's business based on the ordinary course of business until the closing date also have been integrated into transaction documents.

In view of the difficulty of determining a purchase price in times of crisis, earn-out clauses became important in 2021. In an earn-out clause, part of the purchase price is made dependent on the achievement of future success parameters (such as the achievement of certain earnings before interest, taxes, depreciation and amortization results). In the case of a management buyout, this not only leads to increased motivation for the management but, also counters imponderables in times of crisis.

Material adverse change (MAC) clauses were more frequently subject to negotiation in 2021. It has been difficult for buyers to use MAC clauses to cover Covid-19 consequences because, in many negotiations, the seller is interested in explicitly excluding the effects of COVID-19 from the scope of application. MAC clauses did not frequently appear in transaction documents in 2021, but their importance in negotiations has increased.

The repayment of special subsidies and emergency aids granted in connection with Covid-19 must be taken into account when structuring transactions. The repayment of external liabilities is usually already reflected in the purchase price calculation. In individual cases, the purchaser may wish to assume the external financing, which was particularly interesting because of low interest rates in 2021. Also relevant is the extent to which the special assistance influences any future strategic or financial decisions of the target company. The aid granted may be subject to distribution restrictions or limitations on management compensation.

In 2021, W&I insurances gained importance. Almost half of all major transactions were hedged against risks through the conclusion of a W&I insurance.

### 3.4 Tax: Case law on the taxation of management shareholdings

On 1 December 2020, the German Federal Fiscal Court (*Bundesfinanzhof*, BFH) issued two rulings on the taxation of management shareholdings, which weren't published until 27 May 2021. Both rulings deal with the question of the taxation of disposal proceeds from management shareholdings. According to the BFH, the proceeds from the sale of a management shareholding in a corporation do not constitute remuneration for non-self-employed work performed for a subsidiary if the shareholding is to be regarded as an independent basis of acquisition for the generation of income. The proceeds generated from the sale of a shareholding in a corporation do not lead to income from self-employment pursuant to Sec. 18 Income Tax Law (*Einkommensteuergesetz*) if the shareholding is not part of the business assets of the professional activity.

In its rulings, BFH continued its previous case law and confirmed the requirements for the taxation of proceeds from the sale of management shareholdings as income from capital assets.

According to the BFH, the following points speak in favor of the character of a shareholding as a separate basis of acquisition independent of the employment relationship:

1. The employment contract does not provide for an entitlement to acquire the shareholding and a pro rata share of the proceeds from the sale as consideration for the non-independent work.
2. The shareholding is acquired or sold at the market price.
3. The manager bears the risk of loss comprehensively.
4. No special circumstances arising from the employment relationship are discernible that influence the realizability and the performance of the shareholding. Based on those aspects, the capital gain realized by the manager was to be recognized as income from capital assets.

In the case of self-employed consultants, the participation in a corporation may, in individual cases, constitute an auxiliary activity to the self-employed activity. According to the BFH, this is the case if:

1. The activity of the corporation complements one's own professional activity. 

2. Business relations aimed at the awarding of contracts are created with the corporation. In contrast, management participation is not to be allocated to the consulting activity if it has its own economic weight compared to the freelance activity.

The fact that the respective manager has an increased chance of profit does not mean that participation in the company is to be regarded as dependent on the employment and consulting relationship. According to the BFH, this can be inherent in any capital participation. In addition, the manager only receives the share of the profit attributable to the extent of their participation.

### 3.5 Stricter regulatory requirements

Comprehensive amendments to the Foreign Trade and Payments Act (*Außenwirtschaftsgesetz*, AWG) and the Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung*, AWV) went into force in 2020. On 1 May 2021, the 17th ordinance amending the AWV also came into force and further tightened regulatory requirements, particularly through additional reporting obligations and the grant of additional audit powers, especially with regard to key technologies. Several simplifications have also been implemented, however, in connection with the acquisition of company shares and intra-group restructurings.

Sector-specific investment control now also covers acquisitions by companies that develop, manufacture, modify or have actual control over military equipment. It is also sufficient if such activities were carried out in the past and knowledge of, or access to, the relevant technology is still available today.

For cross-sectoral acquirers, AWV expanded the reportable acquisitions by 16 case groups, particularly for future and key technologies (e.g., artificial intelligence, cybersecurity, autonomous driving and critical raw materials).

In 2020, acquisitions in the areas of healthcare and infection control became subject to mandatory reporting. In view of this, as well as with regard to the newly introduced 16 case groups of reportable acquisitions, the 17th ordinance amending the AWV introduced a new review threshold of 20% of the voting shares. The acquisition of additional voting shares is also subject to notification if the acquirer's direct or indirect share of voting rights in the domestic company has already reached the review threshold prior to the acquisition or if voting shares relevant under company law (25%, 50% or 75%) are exceeded as a result of the additional acquisition.

Another significant change was the introduction of an audit power for foreign investments that take place below the percentage audit thresholds but where a non-EU citizen/entity otherwise acquires an effective interest in the control of the domestic company. An example of this is the assurance of additional seats or majorities in supervisory bodies or management or in the case of the granting of veto rights in strategic business or personnel decisions.

### 3.6 ESG

In 2021 the importance of environmental, social and governance (ESG) in corporate transactions continued to increase.

No standards have yet been established in the area of ESG, which also harbors uncertainties with regard to deal sourcing in the private equity sector.

In many cases, an ESG due diligence has been established, in which the target is specifically examined with regard to ESG. No uniform standards for ESG due diligence have yet been developed, however.

ESG considerations also have an impact on purchase price. Risks identified during ESG due diligence can be countered in the transaction documentation (e.g. by including indemnification clauses or special guarantees for compliance with ESG-relevant norms and standards).

Carve-outs are rising in importance in connection with ESG. In some cases, non-ESG-compliant parts of companies are sold off or acquired. In the absence of uniform standards, however, it is challenging to evaluate a company's ESG standards and identify suitable business units to enhance its footprint.

Consideration of ESG criteria is also important in private equity. The acquisition of the investment is aimed at an exit, by which time the importance of ESG likely will have increased.

### 3.7 Investment in SPACs

Overall, 2021 was a record year for special purpose acquisition companies (SPACs), which were flooded with liquidity.

The SPAC market boomed in 2021, especially in the United States. Based on strict stock corporation law and stock exchange regulations, German entities are less attractive for SPACs (at least as far as local IPOs are concerned). From an economic perspective, SPACs can be considered interesting when large sums of money are available in the market.

The merger between SPAC Lakestar SPAC I SE and travel platform Hometogo represents the first successful business combination of a European SPAC with a German target. The merger between SPAC 468 Capital and Toniebox manufacturer Boxine, as well as the merger between US SPAC Qell and air taxi manufacturer Lilium, are also worth mentioning.

The importance of SPACs declined in early 2022. While a total of 92 SPACs went public in January 2021, according to Handelsblatt, there were only 24 SPACs in January 2022. According to Corporate Finance reporting, more than 500 SPACs have yet to announce a merger. Since SPACs usually need to complete a transaction within two to three years, SPACs are expected to be much more active in 2022 and 2023. However, due to the time pressure, this may lead to single, impetuous transactions.

#### 4. Industry sector focus

According to PwC, of the 1,206 transactions announced from January to mid-November 2021 by foreign investors relating to a German target, 328 were in the technology sector. This represents an increase of 50% compared to 2020 as a whole. The industrial production sector saw 257 transactions in this period, representing an increase of 44% compared to 2020, and 219 transactions were related to the retail and consumer sector. The healthcare sector reported 115 transactions.

PwC also recently highlighted real estate (79 deals), media and entertainment (67 deals), financial services (63 deals) and energy (47 deals). The media and entertainment sector specifically has increased in importance compared to the previous year. Completed transactions increased about 71% compared to 2020.

Ernst & Young stated that German IT companies were of particular interest to private equity investors, recording 81 acquisitions in this area. According to Ernst & Young, however, only EUR 3.7 billion was achieved, which underlines that smaller deals were the focus in 2021. (Higher sums were probably paid for by companies in the consumer goods sector.) The acquisition of Birkenstock and Zooplus, among others, were significant in this respect. According to Ernst & Young, the investment volume here was EUR 9.8 billion.

#### 5. Outlook for the remainder of 2022

The outbreak of war in Ukraine in February 2022 and subsequent sanctions against Russia led to an abrupt slowdown in M&A, with transactions completed at significantly lower volumes in Q1 2022. The German Private Equity Barometer noted that the private equity business climate slipped into negative territory at the

start of the year. The war deepened already existing supply chain problems, and inflation increased. There were significant price jumps on the raw material markets and volatility on the European financial markets.

Börsen-Zeitung reported a 10% decline in the German M&A market (involving German companies) to approximately EUR 16.9 billion in Q1 2022 compared to Q1 2021, representing arguably the weakest start to a year since 2016.

These market changes are shifting buyers' interests. According to Handelsblatt, transactions related to renewable energies are a major focus. Wind and solar farms are for sale, and various renewable energy producers and developers are in the market.

Based on the current market situation, small- and medium-sized enterprises could have an increased participation interest by private equity investors, especially because interest rates are no longer low.

In times of crisis, a realistic company valuation is a challenge. Due diligence will become more complex and time-consuming. Extended guarantees or indemnification clauses likely will find their way into M&A transaction documentation, and MAC clauses will gain even more importance.

The most significant driver of the M&A market in 2022 will continue to be the availability of money from private equity investors. The Covid-19 pandemic will drive ongoing digitization and innovation in multiple sectors, including healthcare.

As continue through 2022, it remains to be seen whether the M&A market will experience a only temporary lull, or if there will be longer-term impairments, changes and challenges. ■



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# Sustainability and German MidCap Finance Market

Dr. Oliver K. Hahnelt, McDermott Will & Emery Rechtsanwälte Steuerberater LLP

► Amidst the still lingering Covid-19 pandemic, historic production disruption and shortages in raw material, increasing inflation and the Ukraine war, finance activities continued to be very strong in Germany with a large number of transactions closed in the first half of 2022. This is in line with many other Western European jurisdictions where asset managers report a higher amount of business done in the first half of 2022 than in the first half of 2021.

On the other hand, it is a clear trend that sponsors are increasingly concerned with overpaying for assets in the context of a global revaluation of public market stocks. As a consequence, sponsors on average enhance due diligence processes to assess even more thoroughly transactions risks (e.g., the impact on continuing supply chain instabilities). But enhanced due diligence takes time resulting in transactions to take longer than they did over the last few years, and there is great likelihood of such trend to continue in 2022. Overall, this may lead to a lower number of closed financing transactions, at least in certain segments.

Another trend is that sponsors, investors, corporates and likewise financiers put an increasing emphasis on broader corporate social responsibility and the contribution of investments/businesses to sustainable developments. In that context, environmental, social and governance (“ESG”) issues are on the rise in making investment decisions. What has a longer history in the public markets, has now found its way in the private lending sector as well.

As there is not yet implemented a legal standard neither for addressing ESG issues nor for measuring ESG compliance despite the best efforts of a large number of participants, there is no uniform approach in the German market for sustainability linked loans. However, in the German MidCap financing space most financings concur therein that addressing ESG goes beyond the measurement of mere credit risks but to incentivize a company’s environmental and social impact. By that means, the focus of ESG linked loans is not to finance green projects only, but to measure and monitor ESG compliance against sustainability key performance indicators (“KPI”). Those KPIs may either be very generic or very specialized, but they also link to the inclusion of environmental protections in credit documentation which had disappeared from many leveraged loans.

The setting of the KPIs (as well as the number of performance indicators itself) is left for the participants to decide on a deal-by-deal basis. Within this dynamic, the Loan Market Association has developed Sustainability Linked Loan Principles to promote the integrity of the sustainability-linked loan product in general. Where possible and as a recommendation, KPIs should be, amongst other things, (i) relevant, core and material to the borrower’s overall business, and of high strategic significance to the borrower’s current and/or future operations; (ii) measurable or quantifiable on a consistent methodological basis; and (iii) able to be benchmarked. Whilst it is clear that benchmarking and measurement are key constituents of the KPI indicators,

our experience is that some indicators remain more generic in nature.

As with the setting of the KPIs, there is not (yet) a binding framework as to the methodology of reporting compliance with the KPIs, and there is clear and obvious difficulty in making any framework binding. The market offers everything from external analysis and third party reporting (sometimes proving a formalized ESG rating score) to self-imposed verification and reporting by the relevant company's management. The option selected is the result of negotiation and indeed often driven by the party which is pushing hardest for the inclusion of ESG-linked indicators.

The incentivizing benefit component of the ESG linked financings comes with the pricing ratchet. In practice, failure to comply with the KPIs is generally not subject to a margin premium whereas compliance with all or some KPIs may result in a reduction of the margin. In more recent sophisticated ESG linked financings the documentation provides for the obligation to apply the equivalent amount of the reduced margin in a pre-defined manner (e.g., reinvestment to improve ESG performance), though this is a minority deal feature.

Irrespective of how the German MidCap finance market will develop overall, integration of sustainability-linked (ESG based) feature is and continues to be one of the hot topics in 2022 and we do not expect it to lessen in the near future. ■



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# Notification Obligations for Foreign Investments in the German Health Sector

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## 1. Impact of the Geopolitical Situation on Foreign Investment Control and Notification Obligations in Germany

▶ Germany and the European Union have always been open to investment by foreign companies in domestic markets. There is broad consensus among the German Government<sup>1</sup>, the Federal Ministry for Economic Affairs and Climate Action (*BMWK*)<sup>2</sup>, which is responsible for the review of foreign investments in Germany, and the European Commission<sup>3</sup> that foreign direct investments are indispensable for economic growth, competitiveness, employment and innovation. The Federal Republic of Germany's liberal attitude towards foreign investments has continued to this day. State intervention remains the exception.

At the same time, foreign investment control is a mirror of the global foreign and security policy situation. The increase in protectionism worldwide in recent years, the Covid-19 pandemic, the Russia-Ukraine war, and the tense financial markets have left their traces. The German Government is increasingly reviewing certain investment projects with skepticism, especially when investors are based in less liberal states such as the People's Republic of China,<sup>4</sup> and/or investments are planned in domestic markets or infrastructure that are particularly relevant to the public good.<sup>5</sup>

Against this background, the scope of application and the framework conditions of German foreign investment control have been tightened several times in recent years. One focus of the reforms has been – among other things – the instrument of the notification obligation. An acquirer is obliged to notify certain foreign investments to BMWK immediately after signing of the acquisition agreement and may only complete the acquisition after the BMWK has given its approval (statutory closing condition). Such a notification obligation had already existed since 2002 for foreign direct investments in the armaments and defense sector (so-called sector-specific investment review). In recent times, it has also been introduced and then significantly extended for other sectors, *i.e.* within the scope of the so-called cross-sectoral investment review.

## 2. Overview of Notification Obligations in the German Health Sector

As a result of recent reforms, many foreign direct investments in the German health sector are now subject to mandatory notification and statutory closing conditions.<sup>6</sup> In the following, we provide an overview of the main product and service markets that are affected by this, whereas notification obligations equally apply to share deals (above certain thresholds) and asset deals:

### 2.1 Foreign Investment in Critical Health Infrastructure

The German regulator has introduced a notification obligation for foreign investments above and including 10 per cent of the shares in domestic companies that operate critical health infrastructures.<sup>7</sup>

1 See the response of the German Government to a request (Kleine Anfrage) from the Free Democratic Party (FDP) in BT-Drs. 19/1808, p. 7, according to which foreign investments are an essential "stimulus for growth and employment in Germany as a business location".

2 BMWK regards Germany as "an attractive destination for investment and one of the most open economies in the world", see <https://www.bmwk.de/Redaktion/EN/Artikel/Foreign-Trade/Investment-screening.html>.

3 See Communication C(2020) 1981 final, p. 1.

4 The former Federal Minister of Economics Zypries already emphasized that foreign investment control also protects fair competition and that, in the sense of "reciprocity", special attention must be paid to investors from countries "whose economic system is not as open" as that of Germany, see the BMWK press release of 12 July 2017, <https://www.bmwk.de/Redaktion/EN/Pressemitteilungen/2017/20170712-zypries-besserer-schutz-bei-firmenuebernahmen.html>.

5 The German Government has long considered it necessary to examine particularly critically the planned acquisitions of such infrastructures, which are of "paramount importance for co-existence", see the BMWK press release of 19 December 2018, <https://www.bmwk.de/Redaktion/DE/Pressemitteilungen/2018/20181219-staerkung-unserer-nationalen-sicherheit-durch-verbesserte-investitionspruefung.html>.

6 See section 55a of the German Foreign Trade and Payments Ordinance (Außenwirtschaftsverordnung).

7 The concept of critical infrastructure has come into effect in July 2018 based on the 9th amendment of the Foreign Trade and Payments Ordinance (Außenwirtschaftsverordnung).

Under the applicable laws<sup>8</sup>, critical services in the health sector include inpatient medical care, the supply of directly life-sustaining medical devices, the supply of prescription drugs, and laboratory diagnostics. The regulator has defined the following health infrastructures as critical:

- hospitals if they have 30,000 full inpatient cases per year or more;
- production facilities and dispensing points in the area of directly life-sustaining medical devices with or above an annual turnover of EUR 90,680,000;
- facilities in the area of prescription drugs if they place on the market, manufacture, handle, transport or dispense at least 4,650,000 packages per year;
- blood donation collection and processing facilities or systems if they manufacture or market 34,000 or more products; and
- facilities in the field of laboratory diagnostics if the number of orders per year is at least 1,500,000.

In practice, it can be difficult to assess whether a health infrastructure qualifies as critical based on the above thresholds.<sup>9</sup>

## 2.2 Foreign Investment in Critical Components or Software

Furthermore, a notification obligation applies to foreign investments above and including 10 per cent of the shares in companies that develop or manufacture critical components or software used for the operation of critical health infrastructures.

Critical components involve products where disruptions to availability, integrity, authenticity and confidentiality can lead to a failure or to a significant impairment of the functionality of the critical health infrastructure or to threats to public security.

Critical software, on the other hand, is tailored to the operation of critical infrastructures in the health sector. The regulator qualifies the following as critical software:

- software for the operation of a hospital information system;

- software for the operation of facilities or systems for the distribution of prescription drugs; and
- software for the operation of a laboratory information system.

Such software is already considered critical if it is intended to serve the operation of critical health infrastructures. It does not have to be already installed or deployed.

## 2.3 Foreign Investment in Basic Health Products

Screening foreign investments with the aim of safeguarding domestic healthcare came even more into focus under the impression of the Covid-19 pandemic. In 2020, the German regulator extended the scope of notification obligations to several basic health products, unrelated to critical health infrastructures, in order to ensure the permanent maintenance of a functioning healthcare system.<sup>10</sup> With this reform, Germany followed a call of the European Commission according to which the member states should make use of foreign investment control to prevent third country investments that might pose a threat to national security in the context of the pandemic.<sup>11</sup>

More specifically, the German regulator has introduced a notification obligation for foreign investments above and including 20 per cent of the shares in domestic companies that develop or manufacture the following supply-critical products:

### a) Personal Protective Equipment

The notion of personal protective equipment (“PPE”) is governed by Regulation (EU) 2016/425 and includes equipment designed and manufactured to be worn or held by a person for protection against one or more risks to that person’s health or safety. PPE does not qualify as a medical device.

PPE triggers a notification obligation only where such PPE is intended to protect users from risk category III, *i.e.* from risks that may cause very serious consequences such as death or irreversible damage to health.<sup>12</sup> Such category III PPE involves FFP2 protective masks with the particular objective to protect persons wearing them from hazardous substances (as opposed to medical masks that mainly protect patients from in-

<sup>8</sup> For further details, please see the German Federal Ordinance on the Identification of Critical Infrastructures (BSI-KritisV).

<sup>9</sup> For a summary of the relevant legal and practical considerations when identifying a critical health infrastructure, see Tschammler, PharmR 2019, p. 509 ff.

<sup>10</sup> See BMWK draft of the 15th amendment of the Foreign Trade and Payments Ordinance (Außenwirtschaftsverordnung), p. 10.

<sup>11</sup> European Commission Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe’s strategic assets, ahead of the application of Regulation (EU) 2019/452 (FDI Screening Regulation) (2020/C 99 I/01).

<sup>12</sup> For the sake of proportionality, other types of PPE were not included, see BMWK draft of the 17th amendment of the Foreign Trade and Payments Ordinance (Außenwirtschaftsverordnung), p. 24.

fections carried by doctors and nurses). FFP2 protective masks have been among the first goods in short supply during the pandemic.

### b) Medicinal Products

The notification obligation for medicinal products is directed to finished drugs including vaccines as well as active ingredients or other starting materials for medicinal products, that are *essential to public healthcare* in Germany. *Inter alia*, this relates to drugs whose active ingredients form part of the list of supply-relevant and supply-critical active ingredients issued by the Federal Institute for Drugs and Medical Devices (*Bundesinstitut für Arzneimittel und Medizinprodukte*).<sup>13</sup> Apart from that, there is no further guidance available as to which types of drugs and in which circumstances such drugs may be essential to public healthcare. As things currently stand, this needs to be assessed on a case-by-case basis, considering the needs of the German population, the supply volume of the respective product and other specifics of the individual case.

### c) Medical Devices

Moreover, the scope of the notification obligation covers medical devices as defined in Art. 2 no. 1 of Regulation (EU) 2017/745 that are intended to diagnose or treat *life-threatening and highly contagious infectious diseases*. This includes medical devices necessary for maintaining healthcare in disaster situations, such as surgical masks and ventilators.

### d) In Vitro Diagnostics

Finally, the notification obligation extends to *in vitro* diagnostics (“IVD”) within the meaning of Regulation (EU) 2017/746 that are designed to provide information about physiological or pathological processes or conditions, or to establish or monitor therapeutic interventions related to *life-threatening and highly contagious infectious diseases*. This includes diagnostic tests for the detection of an infectious agent, such as the novel coronavirus that causes Covid-19.

## 3. Summary and Advice for Foreign Investors

German foreign investment control is marked by a significantly increasing scope of the cross-sectoral notification obligation in recent years. Correspondingly, more foreign investments than ever before are current-

ly notified to and reviewed by the competent ministry (*BMWK*).

Some of the recently introduced cases of notifiable foreign investments specifically relate to the domestic health sector: Since 2018, notification towards *BMWK* have been mandatory for foreign investments in certain health infrastructures or related components or software, which are critical for public healthcare. Since 2020, notification shall also be mandatory for foreign investments that relate to basic health products (*i.e.* PPE, drugs, medical devices and IVD) *inter alia* essential to combat the Covid-19 or a potential future pandemic. The purpose of such broader notification regime is to make sure that *BMWK* can intervene where foreign investments might result in supply-critical health infrastructures or products leaving the German market.

In that light, foreign investors should carefully review as part of their legal due diligence whether they need to notify acquisitions in the German health sector to *BMWK*. If that is the case, notification must be made immediately upon signing of the acquisition agreement. In case of legal uncertainties as to whether a notification obligation exists, foreign investors may strive for informal coordination with *BMWK*. Alternatively, in borderline cases, they may also decide to obtain approval from *BMWK* regardless of a notification obligation. Failure to notify despite notification obligation results in the parties to a transaction being unable to close. ■



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<sup>13</sup> See *BMWK* draft of the 15th amendment of the Foreign Trade and Payments Ordinance (*Außenwirtschaftsverordnung*), p. 11.

# Implementation of the “Simple Agreement for Future Equity” (SAFE) mechanisms in Germany

Dr. Nikolaus von Jacobs & Dr. Robert Feind,  
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## 1. Introduction

▶ The Simple Agreement for Future Equity (“SAFE”) is an entrepreneur-friendly and simple mechanism for startups to obtain funding in early stages, such as seed financing rounds. As an agreement between an investor and a startup, a SAFE gives the investor the right to receive equity of the company on certain triggering events, e.g., a future equity financing round. It was introduced by the startup accelerator Y Combinator in late 2013<sup>1</sup> as an alternative to convertible loan agreements and has since then become popular in the U.S. and Canada<sup>2</sup>.

## 2. Early-Stage Investments in Germany

In Germany, SAFEs are not that commonly known or used. Instead, in the venture capital sector, convertible loan agreements continue to be predominant. Interestingly, they are also increasingly used as an investment structure option for private equity investors, particular in growth situations.<sup>3</sup>

The main difference between a SAFE and a convertible loan agreement is that a convertible loan agreement is essentially a loan with an interest rate and maturity date, which can be converted into equity. Under a convertible loan agreement, investors have, unless the

terms otherwise provide for a forced conversion, the right to choose whether they want the loan to be paid back with interest or if they want to convert the loan with the accrued interest into equity of the company. In most cases, the investors choose to convert the convertible loan into equity because due to the qualified subordination clause of the convertible loan agreements, the loan repayment claim is quasi-equity.<sup>4</sup>

For the conversion into shares, the convertible loan agreement can provide for an agreed price-per-share, which requires a company valuation. The agreement can also provide for a discount on a future equity financing round, with the valuation of such a round setting the benchmark for the conversion price. As protection against an excessively high valuation, convertible loan agreements regularly provide for a cap on the conversion price. Discounts and caps are also regularly found in SAFEs.

## 3. Implementation using authorized capital

As mentioned above, SAFEs are not so common in Germany. It is not possible to implement the US SAFE concept one-to-one under German corporate law. However, there are workarounds which can achieve a similar effect.

One way to implement SAFEs under German law can be the use of authorized capital in combination with an equity investment agreement between the company, the shareholders, and the investors.<sup>5</sup> The ▶▶

<sup>1</sup> Stephanie L. Zeppa & Andrew S. Kreider, SAFEs and KISSes Poised to Be the Next Generation of Startup Financing, *National Law Review*, 6 May 2015, Volume V, Number 126.

<sup>2</sup> Marcus Daniels, A SAFE Model for Early-Stage Investing in Canada, <https://betakit.com/a-safe-model-for-early-stage-investing-in-canada/> (last visited 13 August 2022).

<sup>3</sup> Dr. Nikolaus von Jacobs & Matthias Weingut, Convertible loan structures in German private equity: the rise of a new instrument, *Financier Worldwide Magazine*, September 2021, [www.financierworldwide.com/convertible-loan-structures-in-german-private-equity-the-rise-of-a-new-instrument#.YvYdrHZBwfk](http://www.financierworldwide.com/convertible-loan-structures-in-german-private-equity-the-rise-of-a-new-instrument#.YvYdrHZBwfk) (last visited 13 August 2022).

<sup>4</sup> Heribert Heckschen, *Insolvenzrecht in der Gestaltungspraxis* (Reul/Heckschen/Wienberg, 3rd edition 2022), Section 4, ref. 456.

<sup>5</sup> Wolfgang Weitnauer, *Handbuch Venture Capital*, (Weitnauer, 7th edition 2022), Annex (Anhang) V („SAFE“/Equity Bridge Vereinbarung).

existing shareholders provide for authorized capital (*Genehmigtes Kapital*). Under such an equity investment agreement, the investor invests equity into the company against a claim to subscribe for new shares provided for under the authorized capital in the context of a later financing round, such financing round again setting the price or amount of the investor's shares. This structure, as a SAFE, does not have any loan element.

However, in Germany, a capital increase and the subscription to new shares in the course of a capital increase have to be registered with the commercial register (*Handelsregister*). In the commercial register application, the managing director of the company has to assure pursuant to Section 57 para. 2 of the German Limited Liability Companies Act (*GmbHG*)<sup>6</sup> that the minimum contributions have been made and the contribution is finally at the free disposal of the company's managing directors.<sup>7</sup> The staggered timing separation of the equity investment and the later subscription for new shares might lead to difficulties for the managing director's ability to grant the assurance required, as the funds, i.e., the equity investment, will likely have been used at such later point in time. Therefore, in addition to the equity investment, the investor has also to pay the amount of the nominal share value in the course of the future financing round under which the investor will be admitted to subscribe for new shares from the authorized capital. Tax risks, in particular gift tax (*Schenkungssteuer*) risks, might arise as well at the point in time of granting of equity as well as at the later point in time of the creation of the shares. Although these risks typically are dealt with in the context of providing liquidation preferences in the waterfall,<sup>8</sup> this might be a challenge as at the beginning the investor is not a shareholder and at the later point in time it might be questionable whether from a tax perspective the earlier investment can be 'attached' to the nominal capital paid in for the shares.

#### 4. Implementation using preference shares

Another potential mechanism to implement SAFEs in Germany is the issuance of preference shares to the investor against payment of the nominal share value in the course of a standard cash capital increase and an additional payment in the amount of the investment. Since the investor will be a shareholder of the company, the additional payment can be made into the free capital reserve of the company in the meaning of Section 272 para 2 no. 4 of the German Commercial

Code (*HGB*)<sup>9</sup>. Payments into the free capital reserve are only allowed for company shareholders. In order to avoid gift tax issues and to preserve the economic rights of the investor, the equity investment of the investor will be reflected as liquidation preference in the shareholder agreement. Different to the structure using authorized capital where the investor is not a shareholder when investing, here he is. His accession to the shareholders' agreement also safeguards his legal and economic position.

The preference shares which the investor receives in the course of the capital increase, will then be converted into ordinary shares in the course of an equity financing round, the valuation of such financing round again setting the conversion price. The investment and shareholders' agreement will provide for detailed provisions regarding the conversion.

Likewise opposed to the structure under authorized capital (cf. section 3 above), in this way of implementation, the German capital raising provisions (*Kapitalaufbringungsvorschriften*) are safely maintained since the investor pays the nominal share value upon subscription for the new preference shares.

This method of implementing SAFE mechanisms requires an investment and shareholders' agreement as well as capital increase documentation, which all is to be notarized. The SAFE implementation by using preference shares also has no loan element.

#### 5. Summary

For the implementation of SAFEs in Germany, the corporate law particulars must be taken into account. Unlike in the U.S., in Germany, a SAFE has to meet the capital raising requirements (*Kapitalaufbringungsgrundsatz*). This can be challenging as the point in time of granting the investment and the point in time of creation of the ordinary shares in the context of a financing round fall apart. Therefore, the investor has to additionally pay the amount of the nominal share value once the financing round takes place.

This complexity might be the reason for the scarce use of SAFEs in Germany and the overall dominance of convertible loan agreements. Furthermore, the implementation of SAFEs in Germany might trigger upfront costs which exceed the costs of convertible loan agreements. Both techniques of implementing SAFE mechanisms in Germany described above require upfront advisory costs for the structuring and negotiation of the agreements, in particular the investment and

<sup>6</sup> German Gesetz betreffend die Gesellschaften mit beschränkter Haftung.

<sup>7</sup> Hildegard Ziemons, Beck'scher Online-Kommentar GmbHG, (Ziemons/Jaeger/Pöschke, 52nd edition), Section 57, ref. 15 et seq.

<sup>8</sup> Wolfgang Weitnauer, Handbuch Venture Capital, (Weitnauer, 7th edition 2022), part E, I, ref. 15.

<sup>9</sup> German Handelsgesetzbuch.

shareholders' agreement. In the case of a German limited liability company (*GmbH*<sup>10</sup>), which is also for startups the most popular legal form in Germany, a notarization is mandatory and leads to the incurrance of notarial fees. These costs might negate the cost advantage attached to the U.S. SAFEs.

The lack of the upfront notarization requirement is an advantage of convertible loan agreements in Germany. This might be another reason why most German startups seek early-stage financing through convertible loan agreements to keep the structure costs low and avoid notarial fees.

However, it is generally not recommended to invest in either a straight equity or a conversion instrument without safeguarding one's position by a shareholders' agreement. Advantages and disadvantages of convertible loan agreements and the different ways of implementing SAFE mechanisms in Germany may be worth considering. If the investor and startup founders enter into an investment and shareholders' agreement – also

in the event of a convertible loan agreement – implementing SAFE mechanisms might indeed be a favorable instrument of early-stage financing since the position of the investor is likely to be stronger being an equity or equity-like investor from the outset. ■



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<sup>10</sup> German Gesellschaft mit beschränkter Haftung.

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# The German Government's Start-Up Strategy – Ambitious Goals, Much to Do

Dr. Germar Enders, McDermott Will & Emery Rechtsanwälte Steuerberater LLP

► On 27 July 2022, the federal cabinet (*Bundeskabinett*) adopted the first comprehensive start-up strategy of the German federal government. The aim of the strategy is to strengthen the start-up eco-systems in Germany and across Europe. The resolution of the cabinet fulfils an electoral promise that was reflected in the coalition agreement. In particular, the Greens and the Liberals had promised their voters to break with the traditionally rather stepmotherly treatment of start-ups in Germany. The strategy represents a clear commitment to the relevance of start-ups for the social and economic development of the (German) society, a plea for a good investment case. What is envisaged?

## 1. Areas of action

On 28 pages, the Federal Ministry for Economy and Climate Protection elaborates on a series of possible measures to be implemented during the current legislative period. Ten following areas of action have been identified:

1. Strengthen funding for start-ups,
2. Make it easier for start-ups to attract talent – make employee share programs more attractive,
3. Spark the start-up spirit - make the founding process easier and more digital,
4. Strengthen female start-up founders and promote diversity in start-ups,
5. Facilitate start-up spin-offs from academia,

6. Improve framework conditions for start-ups dedicated to the common good,
7. Mobilize start-up skills for public procurement,
8. Make it easier for start-ups to access data,
9. Strengthen real laboratories – facilitate access for start-ups,
10. Put start-ups at the center of economic policies.

## 2. In depth

### 2.1 Funding

With the Future Fund (*Zukunftsfonds*) and its individual modules, the government supports innovative technology-oriented start-ups in their growth phase and is making available EUR 10 billion in public funds through *Kreditanstalt für Wiederaufbau (KfW)* over an investment period until 2030. Together with private investors, the government aims to raise EUR 30 billion in private and public capital. These funds shall be used for important, yet to be prioritized areas of innovation and transformation, in particular artificial intelligence (AI), quantum technology, hydrogen, medicine, sustainable mobility, bioeconomy and circular economy and climate, energy and environmental technology.

The various modules aim at the provision of equity, debt and mezzanine capital to start-ups in their early to late growth phase, partly through direct investment funds, fund-of-funds and venture debt.

In addition to funds and financial instruments that the coalition had already announced or implemented, the federal government shall also provide further means for climate and sustainability technologies in the future. From mid-2022 to 2025, for example, at least one-fifth of new investments under the European Investment Fund shall flow into companies engaged in green innovation, sustainability or social impact. It is also envisaged to revive the INVEST program, which was recently discontinued to the annoyance of many founders. The corresponding funding guideline is planned for 1 January 2023.

Strengthening funding shall be accompanied by adjustments to the legal framework. Envisaged are *inter alia* adjustments to capital market and corporate laws as well as an improvement of the tax framework. In this context, e.g. the requirements for IPOs shall be eased, in particular with a view to facilitating capital market access of small and medium-sized enterprises (SMEs). In addition, the admission of dual class shares and the facilitation of capital increases are being considered. Unsurprisingly for a strategy paper, the resolution remains vague in this respect and it is certainly important to follow if and what concrete legislative changes are made.

## 2.2 Attracting talent

To attract talents and skilled specialists, existing immigration law hurdles shall be lowered and administrative procedures be simplified and sped up (e.g. by introducing a digital visa process). Recognition of foreign qualifications shall be facilitated and the full potential of the “blue card” be exploited. These respective measures are mainly aimed at attracting talents in the IT sector.

Share option programs and other employee participation programs shall be made more attractive for companies and their employees. Germany has some catching up to do compared to the USA and certain European and Asian countries. For start-ups in particular, the granting of company shares as a component of remuneration is an important instrument. Start-ups often do not have the financial means to attract qualified employees through competitive (cash) salaries. In order to make employee share ownership more attractive, the German government plans to amend income tax law. For example, the tax-free allowance for employee share ownership (section 3 number 39 EStG) shall be significantly increased. In addition, the regulations in section 19a EStG on deferred taxation of benefits in the form of shares shall be extended both in terms of time and substance. The aim is to base taxation as far as possible on the actual flow of liquidity. Starting points will

be the extension of the 12-year period as well as the question of how taxation can be handled in practice in the case of a change of employer.

Further measures under consideration concern *inter alia* facilitating the legal framework for remote working and the strengthening of works councils in larger start-ups.

## 2.3 Spark the Start-Up spirit – making foundations easier

The process of founding a company in Germany can be challenging in terms of procedural requirements and time. This shall become easier. To this end, a notarial online procedure for the (cash) formation of a GmbH shall be provided. An establishment of a company within 24 hours shall be possible. This goal shall be achieved, among other things, by linking the relevant online services of the federal government, the federal states and notaries. A digital funding portal shall make it easy for founders to find, apply for and implement possible subsidies.

A significant step towards digitization was taken in August this year: Based on the German Act Implementing the EU Digitization Directive (“DiRUG”) as amended by amendment act dated 15 July 2022 and which came into force on 1 August 2022, an online formation of a German limited liability company is now permissible. The need for notarization is upheld by the DiRUG but may be satisfied by way of a videoconference held by a notary using a specific video portal provided via the Federal Chamber of Notaries. Certain related (unanimous) shareholder resolutions and powers of attorney may be included in the notarization process. Additionally, as of 1 August 2023 further measures shall be open for an online notarization, such as certain foundations in kind and unanimous changes of the articles of association of a GmbH (including capital increases). Restrictions in the online identification procedure (e.g. eID-capable ID cards are required) will probably lead to a rather dragging acceptance of the new procedures. However, a first step has certainly been taken.

## 2.4 Diversity

Studies show that diverse teams are more productive and successful. The promotion of women and diversity in the venture capital market shall be achieved, among other things, through the targeted financial support of funds with a diverse set-up. A new funding line EXIST Women shall be established in the EXIST funding program. In state funds and investment companies, the participation of women in investment committees shall

be strengthened. It is envisaged to improve measures that reconcile family and work (expansion of childcare and modernization of parental allowance for self-employed persons). New forums shall be established to improve networking between founders with a migration background and start-ups, established companies and scientific institutions.

## 2.5 Spin-Offs from academia

More money shall also be made available for spin-offs in the field of science, including biotechnology. Additionally, the Federal government will provide more support for the transfer of intellectual property, including the implementation of standard solutions such as IP for (virtual) shares. Networks, including those at universities, shall be strengthened, and public tenders and procurement processes shall be made easier for educational institutions.

## 2.6 Fostering Start-Ups for the common good

Start-ups dedicated to the common good shall also be provided with suitable funding opportunities and receive a broader platform for public recognition.

## 2.7 Public procurement

In public procurement processes, start-ups shall be given more consideration in the future. Also, they should be able to present their innovations digitally on an e-marketplace which allows an enhanced public awareness. Award procedures in Germany shall be made easily accessible via a central digital announcement platform.

## 2.8 Data access

On an operational level, access to data is critical for future business models. Against that background, the German government envisages the implementation of a whole range of measures:

- The German government will, within the framework of the negotiations on the European Data Act and data rooms, advocate for appropriate incentives for sharing data and for selected mandatory data access. It aims at creating incentives for the economy and at the same time to ensure compliance with data protection standards at European and German levels.
- When setting up the planned data institute, the specific needs of start-ups shall be considered. Planned instruments such as data trustees and data donations should also benefit them.

- Open Data shall, as far as possible and legally permissible, be made available via open interfaces (“application programming interface”, “bulk download”) in a machine-readable form and free of charge.
- The German government is planning AI vouchers for SMEs if they cooperate with start-ups in the use of AI-based technologies. SMEs are often still reluctant to implement AI projects. The vouchers are intended to reduce the SME's financial risk by covering part of the project costs as a lump sum if the SME works together with a start-up. This benefits both, the SME and the start-up. Networking between start-ups and SMEs is promoted by appropriate formats (for example, networking events or funding competitions). In addition, such formats help start-ups to get in contact with and attract new customers.
- In the area of health care, a German and European legal framework should be created that enables the sensible, data protection-compliant handling of health data without hampering innovation and the improvement of care.

## 2.9 Access to reallabs

Real labs make it possible to test innovative technologies and business models in a real environment, which are still limited by the general legal framework. Within the framework of the planned Act on Reallabs, the German government aims to address specific concerns of start-ups, e.g., scalability after testing in the reallab and investment security.

## 2.10 Start-Ups in the centre of Economic Policies

A strong start-up ecosystem requires intense networking of all relevant actors. The German government promises to make its contribution and place start-ups even at the center of its activities by a large number of measures, e.g., by holding a “Start-Up Summit Germany” and by establishing a network of contact points for start-ups in all federal ministries and subordinated authorities.

## 3. Assessment

The strategy paper which evolved from an extensive participation process with workshops and online consultations of involved stakeholders offers a comprehensive and well thought-through concept for promoting young enterprises as drivers of economic, ecological and social dynamics. Accordingly, most reactions so far have been very positive, especially among young entrepreneurs.

At the heart of the government's strategy lie improved financing opportunities for start-ups. Consequently, and quite rightly, *Bundesverband Beteiligungskapital (BVK)* emphasizes in its initial statement dated 27 July 2022, that it is particularly important that the Growth Fund (*Wachstumsfond*), as a central instrument of the Future Fund, is put in place soon.

In addition, the success of many intended measures will largely depend on how precisely the necessary legal regulations will be implemented. This is certainly true for the envisaged tax relief for employee shareholdings (avoiding dry income, i.e. taxation without any liquidity event), the regulations on the facilitated online formation of companies and potential adjustments in the area of IPOs. As far as online notarization procedures are concerned, to date, specific requirements in the identification process and the limited scope of application of the relevant provisions are likely to hinder a fast and widespread acceptance of the new legal framework. With regard to digitization (e.g. digital visa procedures, digital portals to search and apply for subsidies

or the establishment of an e-marketplace to promote innovations), the success of the solutions offered will depend, among other things, on the user-friendliness of the corresponding sites. In the area of improved data access, it will be crucial to see how requirements for easy access to data will be reconciled with high data protection standards in Europe. ■



**Dr. Gernar Enders** focuses his practice on mergers and acquisitions (M&A), private equity and general corporate law. Gernar has extensive experience in advising strategic and financial investors as well as management teams on domestic, cross-border and multi-jurisdictional transactions, and on all aspects of corporate law, including corporate structurings.

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## Game-Changer Geostrategy: The Transactional Ripple Effects

September 20, 2022 – MuMAC 2022 – 8:00 am to 16:25 pm (CEST)

Time	Panel Session A	Panel Session B	Panel Session C
8.00 – 9.00	Breakfast		
9.00 – 9.15	Welcome Opening Statement (Yuriy Yarmilko, Consul General of Ukraine in Munich)		
9.20 – 10.00	Key Note – “The geostrategic shift” (Dr. Stefanie Babst, former head of NATO's Strategic Foresight Team)		
10.05 – 10.45	M&A and Private Equity Market 2022		
10.45 – 11.00	Coffee Break		
11.00 – 11.40	Cross Border M&A from and to the United States and within Europe	Cross Border M&A from and into Asia	
11.45 – 12.25	Crisis and Pre-Crisis Management	Central Eastern Europe: The Good is so Close	Life Sciences
12.25 – 13.15	Lunch Break		
13.15 – 13.55	Finance Function Driver of Value Creation in M&A	ESG: The Operational Perspective	Supply Chain 2.0: Deglobalization and Sourcing
14.00 – 14.40	Mittelstand meets Private Equity	Transaction Financing	
14.45 – 15.25	Case Study: IP and Patent Valuation in M&A Processes	The War Trigger: New Perspectives on Energy and Infrastructure	The Geostrategic Shift as Driver: Technology, Digital and AI
15.25 – 15.40	Coffee Break		
15.40 – 16.25	Healthcare and Private Equity	Shareholder / Post M&A Litigation and Litigation Finance	



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