203 Structuring & Executing an MBO in Europe

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You are In-house counsel working away diligently when you receive a phone call from the President of your company. The President informs you that the company will be saving a bundle of money by not hiring outside counsel and that you will be going to Europe to execute a Management Buy-Out ("MBO").

Many thoughts and responses immediately jump to mind concerning Europe and an MBO – such as "Hope it isn't in Finland in the middle of February", "Paris in the Spring would really be nice", "Really hope it is in England because they speak English there" or "Not on your tin-type -- no way – we better get outside counsel for this one".

For many In-house counsel, the last response sums up many thoughts concerning the mystery and complexity involved in successfully structuring and executing an MBO in Europe. It is definitely not the same as a similar transaction in the United States. We will work here to de-mystify the whole process of structuring and executing an MBO in Europe. When you are armed with some basic information, you will find that the process is not as alarming as first thought. Remember that one is basically looking at a contractual transaction of buying and selling -- no mystery in that. When one can get their hands around the few twists and turns involved in applicable European Union and European Country laws, one can tackle that European MBO whether it be in frozen Scandinavia or on the Champs Éleysées.

UNDERSTANDING RATIONALE FOR AN MBO

The first items in the MBO process that an In-house counsel must understand are the underlying reasons in the first place for spinning-off a product line or operation into an MBO. One must realise that the very reasons for having an MBO may cause the most challenging problems for In-house counsel in execution of the MBO. Let's look at some of the strategic reasons for setting-up an MBO:

1. A company usually looks inward at their core competencies and decides to spin-off a certain operation or product line which does not meet the strategic goals of the company's product range. Strategic reasons may run the gamut from competition driving the strategy to an exiting from a product family altogether.

2. A company may look to spin-off an operation which is not meeting profit goals or one which has high operating expenses. Quite often Far East manufacturing and operating costs are lower than those in Europe and there is stiff competition driving down the margins of European manufactured goods. Some industries are very strict about purchasing European-produced goods whilst others purchase from the lowest cost source, no matter what physical location.

3. Once a decision has been made to spin-off a business, a company usually looks at the highest potential purchase price. In many cases a like-sized multi-national would be the likely buyer. However, when one adds the typically large corporate overheads of a multi-national along with the high labour costs, social costs and environmental costs in Europe, a selling entity may find that no buyer could possibly make a continuous profit in running the purchased operation.

4. A true arm's length sale and purchase transaction takes a long time – in many cases over a year with quite a bit of accounting and legal work involved. This further drains

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resources and the selling company must suffer the continued operation of the business to be sold.

5. Management and key personnel of the business in question would have to know of the sale and could conceivably leave the business prior to the sale, leaving the business devoid of those who can make the business operate. This effectively leaves the attempted sale high and dry.

6. The factors above may ultimately lead a company to decide on an MBO as the only way to achieve immediate goals. Management and key personnel stay in place because they may have a financial interest in the MBO. A smaller MBO operation would be devoid of large multi-national corporate overheads and could increase profit margin to stay profitable in the marketplace. As the buyer would be "family" there would be no long and involved due diligence. The buyers had run the business previously and could seamlessly continue the operation. The company would not be adding product to a big multi-national competitor.

IN-HOUSE COUNSEL MUST GET INVOLVED EARLY IN THE PROCESS

The strategy for effecting an MBO in Europe, as listed above, is fairly easy to understand. However, if one looks closely, one can see the pit-falls inherent in the actual MBO. The biggest single problem for In-house counsel in an MBO is not being involved at the very beginning of the strategy. In all too many cases a company has thought about an MBO and gone through many iterations of a possible MBO strategy before In-house counsel is ever involved. The flawed thought of most companies is that In-house counsel acts "downstream" and only actually executes the final sale documents. This is a big mistake. In-house counsel should, in actuality, be the over-seer of the whole MBO operation – from the very glimmer of strategic thought – through to execution.

The duty of In-house counsel is to protect the company and that is the very heart of the matter in getting involved in the MBO process at the very beginning. The hinge-pin of a true MBO is the continuation and participation of current operation management in the MBO. This can be the single thing which causes a serious conflict of interest. Many high-ranking executives look at balance sheets and margins and a poorly-operating business may be slated for disposal. Most people know that the value of a business on the market is based on the financial performance of that particular business. If the potential buyer is the management of the current operation, what stops the management from running the profit down to such an extent that, by the time the MBO deal is finalised, the selling price is very much in their favour? This is usually not seen by the day-to-day operating personnel. The business is getting worse by the month and that just increases their zeal to spin-off the operation.

The best thing a selling company can do at the outset of spin-off thoughts is to set-up In-house counsel to over-see the "deal". All too often the In-house counsel is presented with a fully-negotiated and set "deal" whether it be price, assets, Intellectual Property or even real estate. Do not wait until too much of the "deal" is set in concrete before getting involved. Get in there and counsel what is best for all concerned. Company management wants to get rid of the challenged or non-core business as quickly as possible and the MBO management want to purchase the business for as little as possible and probably with selling company financing. You, as In-house counsel, may have greater insight into the existence or value of Intellectual Property, tooling,

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real estate and general business contracts. Your job is to make the "deal" happen at the earliest possible date and with the most protection for your company. You must be devoid of profit and loss emotion.

Get in the process at the earliest stage to put in place protections that potential MBO participants will not dilute the value of the operation being transferred. Lead the task force which is empowered to change the "deal" or operation of both the company and the potential MBO participants before the actual transaction goes sour.

WHEN IS AN EUROPEAN MBO AN ASSET SALE?

In-House counsel has several areas to cover in the successful structuring and execution of a complex MBO transaction in Europe. Forms of conveyance and contractual documents differ somewhat from U.S. practice and In-house counsel must be aware of many English Law and European Union regulations under which such a transaction is regulated. Complexities can arise in dealing with proper notice periods in which to undertake the transaction; rights of workers; human resource issues; tax implications of equipment, goods and cash transfer; and various interlocking contractual agreements which must be part of the logical labyrinth of documents required to effect a successful transfer of the operation to the Management Buy-Out.

For example, a real challenge is to understand the fine line between an asset transfer and a "going concern". At the earliest stages one must decide if one is selling essentially a product line or are selling a complete "going concern". There is a great difference. For example, even though one may structure the MBO deal as a product line sale, the way one sets-up the transfer of obligations may decide whether it is, indeed, a product line sale and not a "going concern" deal. Many times one creates a sale document in which the MBO assumes obligations of the selling company in various areas such as purchase contracts, sales contracts, real estate leases, Intellectual Property licensing, etc. With the advent of the "factory within a factory" a specific site, or specific European country incorporated entity may have several product lines. One may want to sell-off a product line which is essentially 90% of an operation, leaving essentially a shell corporation to be wound-up. One should look hard at the "transferring enactment" which is the result of the MBO sale document as this could be construed to be an enactment of a full corporation or "going concern". If the transfer from the selling company to the MBO entity includes a transfer of the selling company's obligations of property, rights and liabilities which may be the majority of the selling company's obligations then the transaction may be considered a "transferring enactment" under certain laws and that means it is a "going concern" sale.[1]

A true asset sale is the simplistic transfer of physical assets whether they be chattel or real estate. This would essentially be a property transaction. It gets a little complicated if the asset sale is more of a product line sale from an on-going business which includes accounts payable, accounts receivable, customer contracts, supplier contracts, software licenses, equipment leases, real estate leases and Intellectual Property. One can generally conclude that one is on thin ice in trying to categorise such a complex product line sale as just an asset sale. An asset or property sale is straight forward in that obligations are not transferred; a "going concern" sale has many more ramifications involved.

There is a fine line between an asset transfer and a "going concern". Of course the simplest would be to have a fully incorporated European division whose shares are sold to the MBO. However in many MBO cases, the selling company wants to continue operations under its

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corporate existence in Europe still manufacturing and selling the surviving product line. This means that the MBO should be structured as an asset sale. Be careful to ensure that one is leaving a truly operating corporation and not a shell to be wound-up. There are different tax implications between an asset sale and a stock sale to be taken into account when one structures the transaction.

One must consider all aspects of an MBO transaction as there are numerous regulatory protections in place in the European Union to discourage foul play[2]. There have been cases in the past in which disreputable corporations, reeling from restrictive union contracts and the high cost of redundancy in Europe, have set-up sham buy-out deals to purchasers with no financial capability to assume any of the employee obligations. In this way some disreputable employers thought to transfer all the liability for worker severance, etc. on a financially insolvent entity and rid themselves of this financial liability. These bogus transfer schemes were seen-through immediately by European legislators and regulations now require a selling entity to ensure the financial stability of the purchasing entity before the transaction so that employee's rights are maintained.

With this in mind, it is important that In-house counsel have a solid financial understanding of the purchasing MBO participants. The In-house counsel should question everything and ensure that the transfer is being done for all the right reasons; this is the way he or she protects their company from legal consequence. If the MBO were to financially collapse soon after a transfer, actions could be taken against the selling party to see if there was any conspiracy to defraud employees of their severance package rights.

Remember that one of the many reasons for executing an MBO is to relieve the selling company of the high costs in Europe of severance pay packages. Do not think for an instance that all costs involved in employee termination are erased with the transfer of the undertaking to the MBO at the Closing or Completion Date. Under European and English Law a selling party's rights and obligations under a contract of employment or from an employment relationship existing at the time of transfer are, by virtue of such transfer, transferred to the purchasing party. This does not get the selling company off the hook completely as it has been ruled in many European Union member states that after the date of transfer the selling party continues to be liable, side by side with the purchasing party, in regard to the obligations arising from employment contracts or employment relationships. The object is to protect employees from losing their earned severance packages, retirement plans, etc. In an MBO transfer in Europe the purchasing party is obligated legally to continue to observe the terms and conditions already agreed in any collective or trade union agreement and must honour all the terms and conditions agreed in such transferred collective or trade union agreement until the expiry of same or the subsequent superseding of a new agreement.

Another item to remember is that in Europe if the MBO results in a substantial change in working conditions to the detriment of an employee under an employment contract, the selling party could be regarded as having been responsible for termination of the employment contract or employment relationship and suffer the consequences of paying out a severance package. The key aspect of this is to ensure that any change is not because of the transfer in the MBO transaction but is something which is completely due to the actions of the MBO purchasing party. In many European MBO transactions, clauses are added which forbid a purchasing party from terminating any transferred employee within six (6) months other than for cause. This usually gives enough time for the acquiring party to stabilise its own business operation and

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make employment decisions based on its running of the business and not as a consequence of the transfer itself.

EMPLOYEES MAY BE INVOLVED IN THE TRANSACTION

It is really simple. The company owns the assets and is free to sell them to the MBO entity. Totally straight-forward – there are only two parties to this normal sale and purchase transaction. Well, not exactly, when one is contemplating an European MBO transaction.

European workers are much more highly unionised than workers in the United States. As an example 83% of Swedish workers are unionised and 90% of German workers are covered by collective bargaining agreements. In virtually all of these collective bargaining agreements, the union is granted rights in any transfer of an undertaking which could affect the workers represented by the union. Such a transfer could be the total sale of the European corporation stock or the asset sale of a particular product line. These rights of representation effectively make the union a party to the MBO transaction. The union could theoretically become the third party in the transaction and can veto decisions by either the selling company or the MBO entity when it comes to the actual "deal". Another interesting wrinkle is that many European countries have union contracts in which the labour unions have a vested interest in any Intellectual Property developed by a company during the term of a collective bargaining agreement. Check thoroughly that one's Intellectual Property is not encumbered in this manner. It has caused many a surprise at the last moment in an MBO transfer.

The Court of Justice of the European Communities has ruled that European Council Directive 11/187/EEC of 14 February, 1997 (dealing with the protection of employees in a transfer of undertaking) applies to all transfers resulting from a contract, an administrative or legislative act, or a court decision. This Court has also held that the crucial criterion for the recognition of a transfer is whether the purchasing party has received an existing undertaking or business so that it is able to continue the exact activities, or activities of the same type. The Court has also held that this particular Directive applies to a transfer of the whole undertaking, business, or part of the undertaking or business, whether public or private, to another employer. There are several interpretative factors involved in deciding exactly what constitutes such a transfer and these include (i) type of undertaking or business, (ii) whether or not tangible assets such as real estate buildings or chattels are transferred, (iii) the value of intangible assets at the time of transfer, (iv) whether or not the majority of employees are assumed by the purchasing entity, and (v) the degree of similarity between the activities of the selling party before and after the transfer. To be covered under this Directive, the MBO should involve the transfer of an organised set of assets by means of which the activities or certain activities of the selling party can be carried on by the MBO entity.

A transfer of undertaking essentially involves the transfer of a business from one legal or natural person to another. This would hold true in a product line asset sale as the seller is the company wishing the spin-off and the purchaser is the MBO entity. Ownership transfer of all or most of the shares in a corporation or a change in the majority stakeholder does not constitute a true transfer of an undertaking as the employer's legal personality remains the same.

Employment contracts are essentially mandatory in all European Union countries. European companies with more than 50 employees usually set up a works council which is comprised of employees elected by the workers. This works council can become a party involved in making

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decisions on the proposed MBO spin-off. As many European MBO transactions may involve multi-nationals or Pan-European firms one should realise that any company with more than 1,000 employees in the European Union or more than 150 employees in two or more European Union countries must also set-up an European Union works council. As one can see, this attaches an added dimension to the MBO transaction. This emphasises the importance of having In-house counsel involved at the beginning of the proposed transaction to protect the company from possible violation of laws dealing with proper notice periods and social partner participation.

The potential employee participation is one of the key reasons why the In-house counsel must be involved early in the MBO development process. The In-house counsel is there in the process to understand the worker or employee representation ramifications of the transaction and what all parties must do. All too often a "deal" gets far along in the stage with a set outcome – only to be changed once the third party is brought into the picture.

Imagine a scenario in which there is no union representation in the proposed European MBO. This effectively makes the transaction simple and straight-forward with no need to get employees involved. Don't bank on such simplicity. Employees will still probably be a key part of the transfer process. In countries such as Germany, Luxembourg, France and Austria the establishment of works councils is statutory. The actual involvement of employees in an MBO undertaking is highly controlled in Europe. As an example in Belgium, France, Finland, Italy and The Netherlands the selling party must make a written request of the works council in enough time for such works council to influence the transfer or sale decision to be made. In other words, the employees are essentially, to some extent, a negotiating party in the "deal".

In the case that no employees are organised into a works council or an employee representative committee, the selling party is still legally obligated to inform, in detail, all employees about the impending MBO and give them adequate time to register opinions, complaints, etc. European Directives have held that each European country national law provide for effective, proportionate and deterring sanctions in the event a selling party does not inform or consult employees or the employee representatives in an impending transfer of undertaking.

PROPER EMPLOYEE NOTICE PROCEDURES

Europe has taken great pains to create statutes protecting the rights of employees involved in a "transfer of an undertaking" which includes either a corporate business sale or an asset product line sale to an MBO. The complex labour statutes and regulations in Europe may have been one of the main factors involved in the strategic decision to execute an MBO in the first place. Notice to employees who will be affected by the MBO transfer is one of the most important items that In-house counsel must address in structuring and MBO transaction. A company does not have to be large in scale before employee notification and consultation rules come into play. As an example, in the United Kingdom, if a transaction involves the transfer, split-up or redundancy of over 100 employees, than there are specific procedures to be followed in notifying employees and allowing them time for appropriate consultation.[3]

As an example, under the English law known as the Transfer of Undertakings Protection of Employment Act or "T.U.P.E.", employees affected in a transaction are to be notified usually ninety (90) days before the transaction in order to give them enough time to take appropriate consultation. One must remember that there will, in most probability, be redundancy involved in

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an MBO transaction as there are various support personnel who may no longer be required in a down-sized business. A good example would be the computer personnel needed to support the total operation who do not transfer to the MBO spin-off because the spin-off is not purchasing the computer MRP system. In only rare instances will employees not be redundant in an MBO transaction.

English law is not the only law which deals with the protection of employees in an MBO transaction in Europe. The European Union has transacted very strict regulations dealing with notice and consultation periods of employees in an impending business sale or transaction.[4] Not only that but the European Union has transacted directives which establish the relationship of "social partners" in business and the establishment of works councils.[5] These European Union directives go even further in setting the timeline for an MBO and the actions of the various parties.

The official notice to employees of the proposed transaction is to be made in writing and is best made in a question and answer format. The notice must inform the employees of the proposed undertaking and the possibilities of some employees being transferred and some being made redundant. The notice must be clear as to what is happening and a timeframe for completion. In any proposed MBO transaction the employee "grape vine" can be way ahead of one's official notice period. Never underestimate the power and importance of the employee "grape vine" as it can do more damage to a proposed MBO transaction than one can think. Make sure that you get the official notice out early – before the "grape vine" distorts facts or gives mis-information. The affected employees probably already know that it is an MBO and who the MBO participants are. These employees are acutely aware of their possible outcome and their relationship with management, whether it be pro or con. Usually the notice will come as no surprise – so be upfront and give particulars of the parties involved.

Let the employees know that everyone wants the transfer to be as smooth and possible and talk about job protection and possible redundancies. Remember that one needs the total workforce to be productive during the notice and consultation period. The object of the various regulations is to ensure that affected employees, during the notice period, have the right to elect Employee Representatives and seek further consultation concerning their rights under the law. The notice should be an informative document rather than just a sterile legal notice. It should be prepared in such a manner as to provide friendly advice on what employees should do. One is required to inform employees of their rights and access to consultation. Usually the notice of a Transfer of Undertaking is presented to the employees along with an all-employee meeting. It is suggested that In-house counsel be on hand to assist with this meeting so that mis-information is not disseminated which could legally harm or hinder the company in its MBO process.

Employees are to be given the right to set a ballot on election of Employee Representatives in case none are already in place representing the employees of the selling company. This election is usually accomplished in a short period of time, normally being between one and two weeks after first notice of the proposed transfer is made to the employees. All employees during the notice period have the right to seek outside consultation as to their rights under the transfer. In the United Kingdom, for example, the government funds the Arbitration, Conciliation and Advisory Service which is a totally independent organisation which can advise both employers and employees about the processes within employment law. There are similar government agencies within other European countries with the similar function.

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Be prepared to defend and clearly show the affected employees the business case for the transfer, the definition of the new organisations for both businesses and the practical issues regarding any physical location of both businesses. There may be a physical change in the work location with the separation of the operations after the MBO spin-off. This could be a totally new location or a separation of different buildings on a single industrial site or industrial estate. Affected employees are to be made aware of any new ramifications affecting their possible commute to a new location. Most MBO spin-offs remain located or co-located in the prior industrial site. Even though most employees who have been working for some period of time may already know the financial status of the operation slated for transfer, one must put in detail the financial picture as to why the selling party is seeking divestiture for its economic health and how a purchasing party receiving the divestiture could stay in good economic health to carry on the operation.

Realise that employees are not assets which can be "sold" in a transfer of undertaking. In Europe a selling party cannot force an employee to be come a transferred employee. One must specifically state in the written notice to the affected employee that such employee is not obligated to transfer to the MBO spin-off. In-house counsel should be prepared to field questions from employees as to why the purchasing party has chosen who it wants to be transferred. Sometimes it may appear to employees that there is a "cherry-picking" of employees in the transfer and that an employee may be better-off staying with the selling party or transferring to the purchasing party. An employee cannot be forced to transfer to the selling party and an employee equally cannot force the selling party to transfer him or her to the purchasing party. The employees should be informed that all terms and conditions of their employment contract will be unchanged in the transfer and that the rate of pay will remain unchanged. Usually pension plans of the purchasing party are not required to be exactly the same as the selling party. Voluntary redundancies are usually not considered applicable in a transfer of an undertaking.

The transfer of a business or part of a business cannot be considered grounds for dismissal by the selling party or the purchasing party. One should point-out that dismissals may take place for economic, technical or organisational reasons entailing changes in the workforce. Dismissals whose only reasons relate to the transfer are prohibited.

A MEMORANDUM OF UNDERSTANDING SETS THE DEAL

Once all legal notifications of affected employees have been made, In-house counsel should busily start drafting the actual Sale Agreement documents. Well, not exactly at this point because most MBO spin-offs require some form of outside financing and this presents a slight delay in proceedings. As we know, most MBO's involve a collection of incumbent managers putting up collateral or funds to purchase their operation. In most cases the cost of an operation, be it a complete business or product line, runs into a large sum of money which is beyond the personal finances of current managers. Many times the selling party will provide some form of financing and the degree of this financing depends on how desperate the selling party is to rid itself of the operation proposed for spin-off.

Most third party financial institutions must perform due diligence on a proposed MBO so they can ascertain the risks involved in funding. As such they usually require a signed contract setting forth the complete "deal" before they will investigate financial underwriting. This is much the same as putting the cart before the horse. One must do the transaction in order to get financing and financing may not be available to seal the transaction. There is where the

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Memorandum of Understanding (MOU) comes in handy. It is quite customary in MBO transactions for the selling party and the purchasing party to execute an MOU which sets forth the exact terms which will be applied in the more lengthy and complex Sale and Purchase Agreement. It is this signed MOU which allows the MBO participants to seek outside financial underwriting. If In-house counsel has been involved from the very beginning of MBO talks, then he or she should be able to draft a succinct document which satisfies both parties. It is in the best interest of the selling party to make it easy for the MBO participant to seek required financing – otherwise the operation in question may have to go on the normal sale block which is much more involved, lengthy and risky for the selling party.

The MOU should be a very concise document with a lack of most of the legalese which most counsel feel would be necessary to protect their employer. In-house counsel must remember that the MOU is a vehicle to effect financing for the other party. As a minimum the MOU should address the following:

1. Exact definition of the "Business" being proposed for transfer. Be careful on how this is definition is constructed as it could create implications in later transactions. Have several financial and operational personnel review the description to make sure it does not intrude into an operation not slated for divestiture.

2. Equipment and agreed value (be it book value or some other agreed value) should be listed in general terms such as "all equipment, furniture and fixtures directly related to the Business". In most cases the equipment and other hard goods are distinct, well-known on an asset list, and easily-identifiable by both parties.

3. Inventory should be noted and should include material, work in progress, finished goods inventory, and current order book directly related to the Business being divested. As the Closing Date is fairly much locked in stone by this time, both parties should have a very good idea of the valuation at Closing. If there are too many variables, then one should draft the document to allow for valuation within a defined period after Closing to set the valuation using the same pricing and accounting methods used by the selling party prior to Closing. As the MBO participants are the ones controlling this, there should be no problem.

4. Personnel should be addressed and a guarantee made (regardless of statutory obligations) that the purchasing party honour employment contracts.

5. Pension fund rights and transfer details should be addressed. In many cases in Europe, pension funds can be transferred up to six (6) months following the transfer date.

6. Intellectual property rights and valuation of same should be clearly stated. In-house counsel should not just check that the selling party has the rights to the Intellectual Property, they should do some real detective work within their own organisation to ensure that trademarks, etc. are not cross-pollinated in different product lines. There have been instances in which a registered trademark was inadvertently transferred to a purchasing party thus leaving the selling party with a problem on their hands concerning the mark used on other product lines. Make sure that there is total severability of any Intellectual Property before it is noted as a transferred asset in the MOU or the Sale and Purchase Agreement.

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7. Historical data which may be found on an MRP or ERP computer system must be clearly addressed. This becomes rather sticky when one realises the many laws regulating data protection and privacy. In-house counsel should thoroughly check all software licences to ensure that a third party (the MBO entity) can legally have access to the data stored using such software. Usually there is one computer system utilised for a multiple product line operation and dismembering a single product line can prove very tricky. Even if one is divesting a complete business with a single computer system it may not prove easy because many computer hardware leases and software licenses forbid assignment or sale. Check these items out thoroughly.

8. Physical facility requirements need to be addressed --- especially in the case in which a product line is divested which will remain on the property of the selling party. Many times physical changes have to be made to buildings, parking lots, etc. to effectively segregate the businesses which will be separate legal entities with separate insurance and security requirements. Ensure that both parties understand how this will be financially handled so there are no surprises.

9. Set clear project time scales for the effective transaction date.

10. Define the segregation of customer accounts as there can be much argument on competition for these accounts. In the event of a product line divestiture, both parties could theoretically be selling to the same customer accounts. Careful drafting of the MOU here will assist the In-house counsel in drafting the Sale and Purchase Agreement so that restraint of trade laws are not violated. One must remember that an MBO spin-off can, in time, become an aggressive competitor to the selling party – with the benefit of lower corporate overhead and lower prices.

11. Excluded assets need to be fully laid-out in the MOU. This could be more important than what is actually transferred to the MBO spin-off entity. The actual transferred assets at this point are rather generalised so take great care in setting forth the excluded assets. This will help a financial underwriting institution get a better picture of the scope of the deal than the brief description of the transferred assets. Imagine bringing a banker to see a business slated for spin-off and mentioning that all the assets seen are part of the business. The banker could envision the building, real estate, mainframe computer system and other items are needed to run the business. Thus it is imperative that the exclusion list be complete in the MBO.

12. The Debtor and Creditor Transfer will be the most troubling part of the MOU or the Sale and Purchase Agreement for that matter. Most other items are set in stone and are easy to define and valuate but the accounts payable and accounts receivable may be a hard target to tie-down. In-house counsel should call on financial experts to help define and control the outcome of this transfer. Remember that the MBO participants are the very same management who are probably controlling the payables and receivables of the operation slated for divestiture. With cunning design the MBO participants could push the receivables out to after the Closing Date and pull in payables prior to the Closing Date which would be in their favour and unfairly to the detriment of the selling party. Get this control tied-down with assigned individuals from both parties to mutually control this outcome so that it is a fair representation of the financial situation at Closing. This single item causes more trouble than most other parts of the MBO transaction.

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13. Liabilities to be assumed should be clearly stated in the MOU with items such as warranty repair, replacement and refund of goods and services taken into account. As the MBO is probably obtaining the complete production business for the specific product line transferred in the transaction and the selling party is usually out of such business, the selling party would not be in a position to honour warranty claims. Thus it should fall to the MBO to take on this liability arising from such claims as the MBO would be the sole provider in a position to effect warranty repair or replacement.

14. Warranty, as it applies to the overall transaction, should be addressed in the MOU. Most of those who have been involved in MBO transactions know that the MBO is effected on a very favourable pricing basis to the MBO participants to entice them to complete the deal with a resultant easy and quick divestiture by the selling party. As the deal is usually uncommonly "sweet" for the MBO participant, it is usually set that the assets are transferred "as is, where is" with no warranty regarding their condition or that the particular assets transferred are sufficient to make any particular product or conduct the business. Full warranties usually run to purchasers who pay full market price. One should definitely note that the purchasing party is responsible for its own due diligence in closing the contemplated transaction. This may sound redundant in that the purchasing party probably know more about the business of the contemplated transaction than the selling party! In-house counsel must be prudent in not creating any inferred warranty liability on part of the selling party. It is most important that the selling party not warrant any level of financial performance associated with the Business contemplated for the transaction. It is up to the MBO participants to convince their financial underwriters that the operation books can be relied upon to set underwriting risk.

15. Confidentiality concerning the undertaking at hand needs to be addressed so that either party does not divulge particulars of the MOU except as expressly agreed.

16. General items such as governing law, superseding other agreements, etc. should round-out a good MOU.

As one can see, the MOU is an important document in the divestiture process which helps speed along the process of the transaction. In-house counsel uses this short document essentially as the "term sheet" for drafting of the lengthy (and more protective) Sale and Purchase Agreement.

STRUCTURING THE SALE AND PURCHASE AGREEMENT

The amount of work that In-house counsel will perform from the initial start of the MBO deal through Closing Day will be enormous. Do not underestimate the amount of resources which this transaction will take. The different laws in European countries will cause one to deal quite differently with many areas of a normal sale and purchase transaction – most especially in areas dealing with taxation, transferring personnel, and contract assignment or transfer.

We won't go into the detail of writing a complete "boilerplate" European MBO Sale and Purchase Agreement here as there is just no boilerplate which could suffice for all the different situations involved in an European MBO transaction. We have already looked at some of the items in the MOU which are transferred and fleshed-out in the actual Sale and Purchase Agreement. We will now look at some of the items which In-house counsel should keep tabs on to ensue that a sound MBO Sale and Purchase Agreement is completed.

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Of course one must have comprehensive definitions in the Sale and Purchase Agreement. Ensure that these definitions are agreed by all parties. Clearly define what is and what is not conveyed. The use of Schedules will allow an exhaustive asset listing. One of the major items which may come-up in the negotiation of an European MBO deal will be the Value Added Tax implications of the deal. There will probably be a lot of assets conveyed at a much better price than fair market value. The purchasing party will want to ensure that their tax impact is as limited as possible in the deal. Both parties are required under European Union national laws to report the transaction to the taxation authorities.

As indicated previously the debtor and creditor amounts for Closing will one of the most heated debates during the negotiation. In-house counsel should get control of this before it gets out of control. The duty of In-house counsel is to ensure that his or her employer is not only legally protected in the transaction but also that they do not get the worst end of the deal. When one is dealing with Transferring Employees, ensure that a complete Schedule is prepared of these employees. Make sure one understands if pension plans are a Defined Contribution Scheme or a Defined Benefit Scheme.

Look closely at any government grants which may have been granted to the selling entity. Government grants, be they for new technology and equipment, employee training, or such items as industrial estate property discounts, may have incorporated some form of claw-back schemes. These grants may not be transferable or assignable and they may be conditional upon pay-back (claw-back) of up to the total original grant amount. It is imperative that all grants be researched in depth to understand any special conditions inherent in them. Many times In-house counsel must go to the appropriate government agencies who made the original grant and plea for grant claw-back relief based on the economic conditions which drove the MBO spin-off in the first place. Some In-house counsel who are not familiar with dealing with European government agencies may be reticent at first to tackle these agencies – especially in a cause of pleading for relief. The best advice to be given here is to get in there and try – you may be surprised at the results you obtain if you have the correct economic story to tell. Do not leave these grant items to become a "surprise" after Closing as such a surprise will most assuredly have negative consequences for the selling party.

Real estate leases need to be examined to see if it possible to assign the lease or even sub-let the premises to the purchasing party in the instance of having a co-habitation of both entities. Zoning ordinances in Europe and the United Kingdom are very strict and any change in the type of manufacturing or production may not be allowed. Check with the local authorities before assuming that there will be no roadblocks. Even though the purchasing party must do proper due diligence, the selling party must also do their own due diligence to ensure that any conveyance is not clouded.

Many multi-national companies are comprised of acquisitions made through the years. Most of these acquisitions involved Intellectual Property. An important aspect of the representations and warranties of the selling party is that all the assets are free and clear for unclouded conveyance. With the flurry of prior acquisitions some of the Intellectual Property being slated for divestiture in the MBO spin-off may actually not be in the legal ownership of the selling party. In-house counsel must ensure that total perfection of title to all Intellectual Property is completed prior to Closing. It may surprise one to learn of the high number of patents and trademarks which are still held in corporate names of companies acquired many years ago and long since wound-up.

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This adds an especially long, involved and difficult wrinkle for In-house counsel to bring perfection up to snuff.

One of the key aspects of Intellectual Property transfer is to define the purchasing party's restricted use of the selling party's Intellectual Property in the transition stage after the Closing. One should tie-down the length of time that the purchasing party may make notation that it was formerly a part of the selling party and at what point all printed matter and advertising will be destroyed which contains corporate or proprietary identity which belongs to the selling party. If it is not tied-down in this agreement, it can cause a long and drawn-out argument which does nothing but to confuse the marketplace – all to the detriment of the selling party.

ANCILLARY INTERLOCKING AGREEMENTS

The transition phase may include supplemental agreements which are essentially interlocking with the Sale and Purchase Agreement. One may add a facility lease or sub-lease for premises and furnishing of shared utilities and items such as compressed air and gas. In many cases the MBO will be considered a semi-captive supplier to the selling party so that the selling party can keep a broad product line with private-labelling by the MBO entity. In this case a supplier agreement will be prepared which ties purchase obligations into pricing which is tied into set levels of quality and delivery performance by the MBO. It is not in the selling party's best interest to have a supply contract with the MBO which is less onerous than any normal supplier agreement.

If one is allowed under computer software licences to provide a transitional information technology service to the MBO then the preparation of such a service agreement would be in place. The actual assignment of patent and trademarks, even though conveyed by the Sale and Purchase Agreement, will require separate assignment agreements. Many of these interlocking agreements may be signed at Closing and some may be required to be executed within a set period of time after Closing. The key is to not set-up another argument or negotiation concerning these additional agreements. Get these agreements in the Sale and Purchase Agreement as exhibits so the parties agree to them and there can be no changing afterwards.

MAKING THE DEAL AN OFFSHORE TRANSACITON

There will be tax implications for the purchasing party in this MBO transaction and as European tax rates are rather high, the impact cold be high for a start-up MBO. As such, many European MBO participants opt to make the actual sale and purchase an offshore transaction to be executed in a tax-advantaged location such as Cyprus.

In order to take an European MBO Sale and Purchase Agreement offshore In-house counsel needs to prepare a Custody Deed which shall set forth the terms and conditions of execution of the Sale and Purchase Agreement. This deed is usually a rather short and simple document and we'll look at some of the key elements intrinsic in same. The Custody Deed essentially is dated the date of the Closing and lists the parties to the transaction. It invokes the actual Sale and Purchase Agreement, describes the transaction and ties the execution of such Agreement to the Custody Deed itself. The key terms in the Custody Deed are that the Purchase and Sale

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Agreement shall be executed outside the country where the physical transaction takes place, usually being the site of the physical asset transfer.

It is of paramount importance that the terms of the Custody Deed note that the Sale and Purchase Agreement shall at all times be retained outside of the country of the physical asset transfer, In most cases one retains the services of a registered agent in the tax-advantaged country to be the holder of the executed Purchase and Sale Agreement. In many instances the selling entity may be a subsidiary or division of an United States-incorporated company and the selling party's copy of the Purchase and Sale Agreement could reside in the United States with the receiving party's copy residing in the tax-advantaged country.

Caveats should be included that no party to the Deed shall at any time cause or knowingly permit any executed original or counterpart of the Purchase and Sale Agreement to be brought into the country of physical asset transfer unless (a) it must be produced in a judicial, arbitration or administrative proceeding, (b) such Agreement is used as evidence in an arbitration or legal proceeding and the judge, arbitrator or other person responsible for the determination thereof has ruled that a certified or notarised copy cannot be produced as adequate evidence, (c) it is subpoenaed to be produced by the country of physical transfer taxation authority or any governmental authority or is legally compelled by a competent authority to be produced in any insolvency or winding-up proceeding.
The Custody Deed, to resolve the dilemma of having to produce an original copy on the soil of the country of physical asset transfer, should have a condition that each party agree in any civil or arbitration proceeding that it will admit the authenticity of a copy of the Purchase and Sale Agreement where the copy is certified to be a true copy by a solicitor, notary or the equivalent, Each party should agree that any inspection of the original Purchase and Sale Agreement is to be done outside the country of physical asset transfer. The Custody Deed should claim governing law as the law of the country of physical asset transfer. Of course the signatories should actually sign the Purchase and Sale Agreement originals outside of the country of physical asset transfer.

CONCLUSION

We've seen that structuring and executing a management Buy-Out in Europe is a multi-faceted legal exercise which needs tight control by the In-house counsel. One, as In-house counsel, is not utilised to one's fullest abilities if one is left to just draft legal words at the end of an already-concluded MBO "deal". Get in there in the beginning and the whole MBO spin-off transaction will benefit from such early action. One may find oneself not only the counsellor but also a "devil's advocate" and even negotiator in the thick of the "deal". It is in the best interest of the selling party to also keep In-House counsel a key part of all negotiations on aspects of the undertaking which are tangential to legal considerations but which greatly affect the drafting of interlocking legal documents.

Understanding regulatory influence on the European MBO undertaking will help In-house counsel draft contractual documents which will be successfully negotiated. Tax and employee aspects of an MBO are different in Europe but can be grasped by an In-house counsel who is experienced in similar deals in the United States. Even if one is utilising outside local counsel, the over-seeing In-house counsel must have a sound understanding of some of the pitfalls ("do's and don'ts") involved in this special type of transaction. This will save time and money and help an In-house counsel provide the greatest benefit to his or her employer in bringing such a MBO divestiture transaction to successful fruition.

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NOTES

1. Part 1 – the Companies Act 1985 (English Law)

2. Paragraph 11.3.2 of the Medium-term Social Action Programme EEC Commission (1995-1997)

3. Transfer of Undertakings (Protection of Employment) Regulations 1994 and the Transfer of Undertakings (Protection of Employment (Amendment) Regulations 1999.

4. European Union Council Directive 77/187/EEC of 14 February, 1997

5. European Union Council Directive 98/50/EC of 29.6.1998 and European Union Council Directive 94/45/EC of 22 September, 1994.

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