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International M&A and Joint Ventures Committee Newsletter

January 10, 2014

Editor's Note:

As we begin 2014, the Committee decided to extend an invitation to our members to educate us on the M&A trends in their home jurisdictions. The reports are in from across the globe and, generally, the trends are mixed with some positive signs of growth for the year ahead to others that, coming off a slower 2013 or in face of new legislative developments, see a choppier year ahead. Initial statistics seem to confirm this trend. Mergermarket's most recent *M&A Trend Report: 2013* indicated a small decrease in deal value and volume over 2012. In fact, according to that study, the last three years remain largely static, after an initial bounce back from the lows of 2009 and 2010.

While large growth areas in the M&A market may be hard to find, we present herein a fascinating read of legal and market insights from a broad base of 13 countries. Here's hoping, on balance, it is a more positive year for us all and that the trend lines in all of our jurisdictions head up!

Best Wishes for the New Year,
Gordon Cameron

IN THIS ISSUE

Country Updates

COUNTRY UPDATE ON BRAZIL

M&A in Brazil – 2013 Year in Review

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The year of 2013 has marked a downturn of Brazil's growth trend of the recent past, with rising inflation affecting consumption and disappointing developments in the country's infrastructure, a factor commonly blamed for hindering Brazil's economic performance. Still, when compared to Latin America as a whole, Brazil has maintained leadership within the region as the target for mergers and acquisitions, concentrating approximately 57% of the transactions and surpassing 30 billion Dollars.

It was, however, the lowest point in eight years, despite a minor recovery towards the year end. For instance, the first half of the year registered US$ 20.4 billion in acquisitions, down from US$ 45 billion during the same period of the previous year, according to data by Thomson Reuters. By October, though, the accumulated number of mergers and acquisitions reached 664 transactions, compared to 655 for the same period in 2012, as a PwC report showed.

Research studies by EY have indicated a trend showing that Brazilian companies have focused more on the optimization of its businesses and cost controls, rather than emphasizing corporate transactions.

Consumer goods have remained as the sector representing the highest values, but chemical products have been the busiest, with over 60 transactions.

Some relevant cases were the purchase of Spaipa, a drinks manufacturer, by Coca-Cola for US$ 1.85 billion; the sale of FMU, a university, to the American group Laureate; and some deals in the energy sector, such as the purchase of Renova Energia by Cemig, one of the main energy companies in Brazil for US$ 615 million and the wind power project BW Guirapá I, in Bahia State, by the Santander Bank, for US$ 65 million.

Perspectives for 2014 are slightly more optimistic, although largely due to Brazil's hosting the World Cup, an event that may be particularly helpful to some sectors more than others. Construction and real estate have benefited largely in previous years and may continue to grow. It is believed that the tourism industry, food and drinks, banking and credit cards may also see developments.

A poll made with investors, lawyers and business executives revealed that 52% of them believe the M&A market will grow in the next year. Most of these believe in a moderate increase. 32% believe the markets will remain in the current levels and 16% bet on a decline, but no one thinks there will be a severe fall.

COUNTRY UPDATE ON CANADA

Energy M&A Trends in Canada for 2014

By Gordon N. Cameron, Principal, New York, NY, USA (gncameron@stikeman.com)
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Whether measured by volume or aggregate value, 2013 was a weaker year for energy-related M&A and continued a four-year decline in activity in the sector. The reasons for such a decline included a few that will likely have a chilling effect on growth for 2014, including:

- Asian investors paused to digest what they bought after five years of significant investment in the Canadian energy sector, particularly in the oil sands.
- Changes to Industry Canada's State Owned Entity ("**SOE**") guidelines under the Investment Canada Act (the "**Act**"), coupled with the failure of two transactions to pass "national security" reviews, have cast a shadow over foreign investment by SOEs.
- Increased uncertainty about whether regulatory approvals would be obtained for pipelines and other projects needed to expand the capacity to transport Canadian crude oil and natural gas to the U.S. and to provide access to offshore markets contributed to investors' concerns about the future prospects for Canadian production.

It has been just over a year since Prime Minister Stephen Harper's announcement – following months of controversy – of reforms to the Act that effectively prevented further acquisitions of majority stakes by SOEs like CNOOC and PETRONAS in the oil sands, and appeared to cast a pall over the perception of Canada as a welcoming destination for foreign investment.

The changes were enacted in June 2013, although not all of the changes have taken effect. The SOE guidelines were amended to clarify that, in addition to considerations regarding the corporate governance of the investor and its management on profit-maximizing lines, the degree of foreign-state control of the SOE would be considered, along with the importance of the Canadian target in the industry and the degree of existing participation of SOEs in the sector. Majority acquisitions in the oil sands by SOEs will be permitted going forward only on an "exceptional basis".

The Act itself was also amended in June 2013 to include a broad definition of SOEs – including entities that are "influenced" by foreign states. The Minister has been given the power to determine – retroactively – whether an investor is in fact an SOE or in fact controlled by an SOE, even if it does not meet the test for "control" that otherwise applies in the Act. As well, the higher dollar thresholds for the review of transactions by Industry Canada will not apply to SOEs.

At the same time, the Government began to use its new (since 2011) national security powers under the Act. Despite pronouncements welcoming – indeed urging – foreign investment in telecommunications, national security reviews led to the demise of two proposed high-profile telecom investments in Wind Mobile Canada and in Manitoba Telecom's Allstream division by foreign acquirors.

Together with depressed prices for Canadian oil and gas production, high costs and regulatory burdens, the uncertainty over deal completion created by Ottawa's pronouncements on SOEs and its unexplained rejections of the telecom deals has poured cold water on foreign investment in the energy sector.

COUNTRY UPDATE ON CHILE

M&A trends in Chile

By Francisco Ugarte, Partner, Carey, Santiago, Chile (fugarte@carey.cl)
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For the past years, Chile has been recognized as one of the most stable and investor-friendly economies of Latin America. The country's favorable M&A regulation has boosted the M&A activity and has pushed it to the third place after the biggest economies of the region, Brazil and Mexico. In 2013, for the eighth consecutive year, Chile led the LAVCA's Scorecard on the private equity and venture capital environment. The country also improved its score compared to 2012 due to the adoption of international financial reporting standards by non-listed firms.

During the first, second and third quarters of 2013 there were 41 deals valued at US$5.231 billion[1], based on announced deals[2] where the target dominant geography was Chile. Many of these transactions were related to divestitures by European companies affected by Europe's economy situation, such as the sale finalized in October by the Spanish bank BBVA to MetLife, Inc. of 64.3% of AFP Provida S.A., the largest private pension fund administrator in Chile, for US$1.5 billion. Additionally, continuing with past trends, several Latin American groups have continued their expansion throughout the region, like SURA, BTG Pactual, Brescia, Falabella, Corpgroup, BC Peru and Cencosud.

In terms of economic sectors, the high price of copper and the ample availability of commodities and raw materials have presented attractive opportunities for international investors. As a result, the mining sector continues to dominate the Chilean M&A landscape, notwithstanding the increasing relevance of energy, infrastructure and financial institutions.

Going Forward

Although political risk is very low in Chile compared to other countries in Latin America, investors still face certain minor political risks associated to M&A transactions, particularly in those involving protected or regulated sectors like energy, natural resources, financial services and state-owned companies. Additionally, on December 15, 2013, Chile held a general presidential election in which the former president Michelle Bachelet was elected for the 4-year period beginning in March of 2014. Miss Bachelet, has announced that she will increase corporate taxes to finance an educational reform. The feasibility and consequences of this tax reform are yet to be seen and may have certain impact in the M&A activity.

Notwithstanding these minor risks, the outlook for Chilean economy remains stable and it is expected that international interest in Chilean markets and inbound M&A will keep growing as they have been doing it for the past years. Chile's favorable legal system will also contribute to this growth, as the country has one of the most praised legal environments of the region.

As in 2013, we anticipate that hostile takeovers will remain very rare and shareholders activism limited. In connection with antitrust, however, Miss Bachelet's government program includes a mandatory premerger control which is currently voluntary in Chile. As of this date, there is no legal obligation to previously notify a transaction or to make any filing seeking approval of the same. Notwithstanding the foregoing, the parties to such operation or transaction may voluntarily request its approval to the Antitrust Court by initiating a voluntary consultation proceeding. Miss Bachelet's proposal follows the trend that we have seen in the past years, given that the Economic Prosecutor ("Fiscalía Nacional Económica" or "FNE")[3] has become increasingly proactive to investigate mergers from an antitrust stand point.

1. Source: http://www.mergermarket.com.
2. Excluding lapsed and withdrawn transactions.
3. The FNE is an independent administrative body principally in charge of investigating any facts which may constitute violations to the antitrust laws.

COUNTRY UPDATE ON DENMARK

Updates from Denmark

By Nikolaj Juhl Hansen, Managing Partner, Magnusson Law, Copenhagen, Denmark (nikolaj.juhl.hansen@magnussonlaw.com)

2013 overview

After some difficult years, the Danish M&A market is showing a slightly positive trend after Q3 2103. The number of Danish companies sold has increased by 13% against Q3-2012 and looking at Danish companies sold to foreign buyers the increase stands at 27%. Private equity acquisitions have seen a 19% uplift.

There are multiple drivers behind this increase in activity. The macro-economic outlook for Denmark is positive and share prices in Denmark have done well in 2013. Increased activity both from PE houses and industrial players, many of which are cash-rich, also plays an important role.

Finally, a structural aspect of Danish business life also comes into play: Many of Denmark's SME companies are privately owned, and many are rapidly approaching a time when a generational transition is needed. Due to the price drop caused by the financial downturn a lot of transactions with this type of companies were postponed and those companies are now – more or less reluctantly – coming back onto the market. But, a number of market commentators are saying that price expectations on the sell and buy side, respectively, still vary too much for Denmark to be able to generate a real boom on this account.

In terms of sector trends, IT services, industrial and consumer goods have seen the highest number of deals in 2013. In terms of geography, Denmark is still lacking behind when it comes to acquisitions made by players from the „new economies". 71% of buyers are from Europe (and 31% even come from the Nordic region) and with also 25% coming from North America only scrapplings are left for others.

In relation to Danish outbound investments, the deal volume is behind Q3 figures for 2012, but activity has picked up significantly in Q2 and Q3 after a very slow Q1 2013. Investments are predominantly made close to Danish shores with almost 90% of deals in Q3-2013 being in Europe; many in the Nordic region.

Legislative update

The Danish Government has in October 2013 proposed changes to the existing take-over regime for listed companies. One of the proposed new rules will see the threshold for mandatory bids to all shareholders lowered to a threshold at which a shareholder controls a third of the voting rights or more, bringing the rule in line with other European countries. Another proposed change is of a more fundamental nature; it concerns the obligation to put forward a mandatory bid when 2 or more shareholders act in a concerted manner. The current rule requires that shares change hands before such an obligation arises, whereas this is not the case under the proposed new regime. In the new regime the concerted practice alone will imply a duty to make a mandatory bid. Legal practitioners have opposed the new system citing that it creates uncertainty. First, the time when the offer should be put forward and the price of the offer (since no shares are traded) are both difficult to manage. Furthermore, it seems that the rule may limit concerted attempts to exercise "active shareholdership" in a listed company since the active shareholders that coordinate efforts risk being forced to acquire the company. This seems to contravene the current Danish Corporate Governance Guidelines that reinforce the necessity of active shareholders. Other proposed changes are that the area for relief from the obligation of the mandatory bid when decisive influence has been obtained through a voluntary offer is diminished and existing shareholders will now be entitled to benefit from improved conditions of an offer also during a period after the end of the bidding period.

Not news, but worth mentioning - especially in a Danish-US context - is the Danish system for indemnity for breach of warranties in M&A deals. In purchase contracts governed by US law you would allow a buyer to claim indemnity from a breached warranty albeit the buyer had knowledge of it being breached when the deal was signed. The breach of warranty carries so to say the right to indemnity. In Denmark the Danish courts would rarely allow a buyer to claim indemnity for a warranty of which the buyer knew or should (through due diligence) have known that it was breached. Instead the buyer must ensure that the issue is dealt with through a "specific indemnity", i.e. a negotiated solution of how to handle issues uncovered during due diligence. From experience we know that this system often comes as a surprise to US buyers.

<u>Trends for 2014</u>

Many of the aforementioned Danish SMEs offer good products or services, but have to large extents failed to internationalize. If these SMEs are to secure themselves a solid place in the new global economy internationalization will be a key issue. During 2013 Magnusson advised a Danish technology company on setting up a joint venture in Hong Kong where it partnered with a Hong Kong listed Chinese company. The deal structure saw the Danish IP rights transferred to a Hong Kong vehicle, which was then capitalized by the Chinese company that also brought manufacturing capability in mainland China and sales channels to the joint venture. In times of fewer M&A deals this structure might provide an alternative to being acquired for the Danish SMEs, albeit it does not yield the same immediate return on investment as an outright acquisition. At Magnusson we are eyeing quite a few of this joint venture type deals that may well go live in 2014.

We expect deal volumes to increase slightly again in 2014, and as the number of deals hopefully continue creeping back up we expect sectors like IT services, industrial and consumer goods to lead the way. Denmark was recently first in the world to be approved to supply processed pork meat to China, and the increasing demand for high-quality food in new economies may also well drive M&A and joint ventures within the food sector.

COUNTRY UPDATE ON FINLAND

New Finnish Thin Capitalization Rule Impacting Private Equity Deals

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(Professional Support Lawyer Kristina Rutsky also contributed to this article)

At the end of 2012, the Finnish national government agreed upon government spending limits for the years 2014-2017. In connection with adoption of those limits, the Finnish government also adopted numerous reforms to the Finnish taxation laws, some of which became effective in 2013 and some of which are set to become effective in 2014. One of these reforms likely to affect both domestic and cross-border private equity investments in Finland will be the new thin-capitalization rule.

Prior to the adoption of the new thin-capitalization rule, all arm's-length, business-related interest payments were tax deductible without limitation. Beginning as of 2014 tax year, tax deductions of interest payments paid in connection with certain types of debt financing will be subject to new limitations. Key details of the new thin capitalization rule are the following:

- *<u>Applies only to intra-group arrangements</u>*. Only interest paid on intra-group debt financing will be subject to the limitation on deductions. The new rule does not differentiate between purely domestic financing and cross-border financing. Interest payments made to third parties will be exempt from the limitations, except when a group company receivable is used as a security. The fact that e.g. shares in a subsidiary would be pledged as security for a bank loan would not result in the loan being regarded as an intra-group loan. Payments made to third party intermediaries who simply transfer the payment to the intra-group lender will also be treated as intra-group interest payments and are subject to the limitation on deductions.

- *Interest expenses annually over €500,000 and exceeding 25% of the adjusted EBITDA will become non-deductible*. Interest payments in a total amount of €500,000 or less per annum will be exempt from the limitation and may continue to be deducted in full. Interest paid on funding obtained outside the group is included in calculating the annual €500,000 limit, despite the fact that the limitation on deduction only applies to intra-group interest. For interest payment amounts which exceed the annual €500,000 limit, those interest payments can be deducted up to a maximum of 25% of the debtor company's adjusted EBITDA. Further, when calculating the adjusted EBITDA for tax purposes, certain write offs and other losses on financial assets cannot be added back to the adjusted EBITDA.

- *Carry forward*. Net interest expenses which cannot be included in the current year's deductions may be carried forward, however, the same restrictions apply each year.

- *Safe harbor*. A safe harbour is available for companies whose equity to total assets ("equity ratio") is equal to or greater than the equity ratio on the consolidated balance sheet of the group parent company. In such case, the Finnish debtor company may deduct the full amount of interest paid on its intra-company debt financing.

- *Bonds and cash pooling not effected*. Interest paid on bonds or to cash pooling arrangements in which the assets of the group companies are managed centrally by one group company will continue to be exempt from the deduction limitations and may continue to be deducted in full. It is possible that bond financing will replace much of the bank financing that is currently in place in LBO arrangements due to the interest expense maintaining its status as being fully deductible (even in secured bonds vs. bank loans that secured by an intra-group borrower).

With the new restrictions set to have effect as of tax year 2014, investors would do well to re-evaluate their investment financing structures for their Finnish investments both for planned investments as well as for existing ones (the restrictions discussed herein apply to existing financing arrangements as well as new arrangements to be established in the future), to ensure that the potential tax exposure of their investments is minimized. The safe harbour discussed above may provide protection for some investors, but for others it may be necessary to restructure existing and planned financing arrangements so that financing will be given by external parties in order to preserve the right to deduct all interest payments from the Finnish debtor company's taxes.

COUNTRY UPDATE ON GERMANY

"Modernization" of Notary Fees Act: Impact on M&A & JV, Notarization in Switzerland

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Background

As of August 1, 2013,the 2nd Act on Modernization of Cost Rules resulted into the modernized German Court and Notary Fees Act (Gerichts- und Notarkostengesetz/GNotKG) which replaced the old (Kostenordnung/KostO). The new law provides for a clearer structure but also – in most cases – for a more or less substantial increase in fees. It also covers the pretty reasonable fees for a simple signature verification (Beglaubigung), however, of much more relevance is the full notarization of a transaction. Notarization requires that the entire deed including its attachments is read aloud in the presence of a notary and all parties (or their proxies such as their attorneys). The German notary, even if also admitted as an attorney, is serving in a public capacity and is liable to both parties as to the validity of his deed. His fees under the above mentioned fees act are not negotiable and subject to a regular fee audit by the competent authority. Especially for parties from non-civil law jurisdictions, both the time-consuming process as well as the level of notary fees for transactions with substantial values may be surprising. In 1980, the German Federal Court of Justice approved the notarization of a transfer of shares by a Swiss notary. This alternative is discussed in the end of this Update.

Typical M&A transactions requiring Notarization and their fee new levels

Share deal: The transfer of shares in a closely held corporation (GmbH) requires Notarization, but not the transfer of shares in a public corporation. Under the new fee act, the maximum underlying value (purchase price) is still capped at EUR 60 million which now results into a fee of EUR 53,170 plus VAT. However, group companies now benefit from an exception providing for a reduced maximum transaction value capped at EUR 10 million for share transfers between affiliated entities which results in a maximum fee of “only” EUR 22,770 plus VAT. However, there is a counter-exception for those affiliated entities where the effected entity (whose shares are transferred) is not an operating entity but a mere holding, investment or other passive entity. Consequently, the above exception reduces the reorganization costs of groups only if active operating companies with high underlying values are involved. The afore exception does obviously not apply for a typical SPA which involves unrelated parties but may also be helpful in a pre- or post-closing situation.

Asset deal: A standard asset purchase agreement does not require notarization unless there are relevant assets, such as GmbH shares or real estate, which by themselves may only be transferred by way of notarization. A separate notarization of the transfer of real estate which is a mandatory component of the transferred business bears the risk that the entire transaction may be held void due to lack of the notarial form for the rest of the assets. For the transfer of real estate as well as for the entire asset purchase agreement, the underlying transaction value is based on the purchase price or the actual market value and only limited to the general maximum value of EUR 60 million.

Entity transformations: For transformations under the German Transformation Act (Umwandlungsgesetz) such as mergers, split-ups, split-offs, or changes of the legal form, the underlying value is now capped at EUR 10 million (previously EUR 5 million). However, as an example, in addition to the transaction value for the merger agreement, another EUR 5 million (capped) for the also required notarization of shareholders approvals is to be added. Thereby, the underlying value for a merger is increased to a combined value of EUR 15 million resulting in a total notarization fee of EUR 28,700 (maximum fee) plus VAT. If additional actions need to be taken together with the merger such as a capital increase, extra notary fees will become due.

Profit and loss pooling agreement: Following the successful closing of a transaction with at least two German entities involved, the acquirer may want to optimize the tax situation by setting up a group-taxation (Organschaft). Although the underlying profit and loss pooling agreement does not require notarization, at least the shareholders approval by the shareholders of the involved subsidiary must be notarized. Again, the maximum value of such a shareholders resolution amounts to EUR 5 million and results in an isolated maximum fee of EUR 16,270 plus VAT. Under the old law, the maximum fee amounted to some EUR 5,000 plus VAT.

Notarization in Switzerland

It goes back to 1980 when the German Federal Court of Justice decided that the notarization of a transfer of

German GmbH shares by a notary in Zurich, Switzerland, was valid and to be accepted under German law. In the following, this has been confirmed by other court decisions not only for the canton of Zurich but also for Basel and Zug. Notarization in those cantons became very popular especially as, depending on the underlying value of the transaction, the fees to be charged by a German notary based on the statutory fee table are substantially higher than those in Switzerland. In certain cantons fees can even be negotiated.

Due to a change of German law on limited liability companies back in 2008, this common practice was challenged not only by German notaries but also by the District Court of Frankfurt in an obiter dictum of 2009. Under the revised act on limited liability companies, the notary who was involved in a transfer of ownership in GmbH shares is obliged to issue and file a new shareholders' list reflecting that change. According to the Frankfurt district court, this change in the law should have put an end to notarizations by foreign notaries as the German law obligation to issue and file the shareholders' list could not be imposed on foreign notaries.

However, in 2011, the Higher Regional Court of Düsseldorf court held that a foreign notary, like the Basel notary acting in that case may still validly notarize a share transfer under German law and also issue the new shareholders' list. The court further stated that the filing of the shareholders' list with the commercial register – which can only be done electronically based on a respective certified registration of the notary – could also be completed by a German notary acting as a messenger of the foreign notary. In 2013, the Higher Regional Court of Munich (OLG München) took a different approach and decided that a Swiss notary who notarized a share transfer under German law is not allowed to certify and file the new shareholders list. However, in the absence of a German acting notary, the GmbH´s managing directors would be in charge instead.

Consequences

The decisions of the OLG Düsseldorf and the OLG München indicate that the new rules regarding the issuing of a shareholders list do not prevent the notarization by a foreign notary as such, but only the signing and filing of such list by a foreign notary. Of course, as long as the Federal Court of Justice has not decided on this issue, a certain risk will remain. In practice, it is highly recommended to contact the competent commercial registers in advance in order to obtain their prior approval on the acceptance of a Swiss or other non-German notarization of the contemplated transaction. In our experience, several commercial registers have accepted Swiss notarizations from the above-named cantons for the transfer of GmbH shares. Some even tend to accept other notarizations such as those under the German Transformation Act which, however, have never been subject to a decision of the Federal Court of Justice.

Swiss notarizations are not uncommon for intra-group transactions involving German entities. They are usually not used for M&A transactions with unrelated parties in order to prevent that a buyer may try to challenge the validity of the notarization when he is looking for ways how to avoid closing.

COUNTRY UPDATE ON HUNGARY

M&A Trends in Hungary in 2014

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In the last couple of years, Hungarian politics has been characterized by increasing state intervention in the economy, which is likely to impact on transactions in 2014 as well. The most important examples of such tendencies are the following:

- Tobacco shops and pharmacies: According to new legislation introduced in 2012[2], previously liberalized tobacco retail trade is now subject to government concession. Thousands of small entrepreneurs who did not win concessions were forced to give up their trade. Similarly, previously liberalized rules for the retail trade of pharmaceuticals were reversed[3]: only pharmacists can have a majority ownership in a limited number of pharmacies and financial investors, who currently own a large part of pharmacies in Hungary, will either be bought out by their professional pharmacist partners or - if the pharmacists do not want to or are not able to buy out their partners - by the state.

- Companies in liquidation: According to a 2010[4] amendment to the rules of the forced liquidation of insolvent companies, the government can qualify a company under liquidation as a company of strategic importance by decree. Any such company is under special liquidation rules, involving management by state liquidators and the possibility to sell assets without public tenders (normally a strict requirement of selling liquidated companies' assets). Applying such rules, the government has already taken over and continues to operate (or has announced plans to do so) the full business of bankrupt companies in the aluminum production sector, in the meat processing sector and in retail trade.

- Mobile payment: According to a law in 2011[5], only the state can operate the mobile payment systems relating to public services, such as road fees, parking fees and public transportation tickets.

- Pension funds: In 2010 and 2011[6] the government changed rules relating to private pensions fund. Previously mandatory pension fund payments were made optional and existing savings were encouraged to be moved to the state pension fund, under the threat of new pension rules stating that those who do not move their private pension fund savings into the state pension fund will lose their right to a state pension. This resulted in nearly 99% of people moving their savings.

- Waste management: According to an amendment of legislation relating to waste management in 2012[7], only companies in majority state ownership can carry out public waste management.

- Water supply: On the basis of an amendment of rules relating to state asset management in 2012[8], there is now legal basis to enact laws, which restrict public water supply services to state owned companies.

- Retail energy suppliers: In 2013[9], the government enacted two sets of rules decreasing the fees of retail energy suppliers. Rates are down almost 20% from a year earlier, with companies providing natural gas and electricity at cost. At the same time, government officials made statements suggesting that they are ready to take over the energy suppliers that cannot support the sharp decrease in margin. The Hungarian government restated its ambition to renationalize utility companies following MVM's purchase of E.ON's gas business in March 2013.

- Oil, gas and other strategic purchases: In 2011 the state purchased a 21% block of MOL shares from the Russian Surgutneftegas, increasing its stake to 27%, and a 10.85% stake in the truck manufacturer Rába, increasing its holdings to above 73%. In 2012[10], the government adopted legislation requiring that security gas reserves be owned by the state. Simultaneously, it started negotiations and then through MVM acquired from E.ON the gas reserve and gas wholesale business in a commercial sale and purchase transaction in March 2013. Later in 2013 the state-owned Hungarian Post Zrt. and FHB Mortgage Bank Co. Plc successfully closed the deal related to the acquisition of Díjbeszedő Holding Ltd. and its subsidiaries, the market leading utility fee and trade accounts receivable collection and factoring company group.

As can be seen from the above, political interference has become an issue, particularly in regulated sectors and will impact the 2014 M&A trends. It has also raised the attention of the European Union, currently investigating some of the rules, and the European Commission, which already initiated an infringement procedure against Hungary.

Nevertheless, local advisers and bankers are urging investors to keep an open mind, as tax incentives, legal certainty, an impartial judiciary and efficient enforcement of court judgments are still attractive to private investors and opportunities remain in Hungary despite interventionism. According to Goldman Sachs, there will be further emerging markets differentiations in 2014, and Hungary with its underheated economy is likely to benefit from stronger DM demand and inflation-less accelerations[11]. "An uninterrupted monetary policy easing cycle, a current account surplus and signs of stronger pre-election fiscal discipline are underpinning favorable sentiment towards Hungarian assets. Increasing evidence of an economic upturn in Germany, Hungary's main trading partner, bodes well for an export-led recovery."[12]

In addition, foreign investors in Hungary enjoy the protection of EU rules and 58 bilateral investment treaties. Hungary is also a party to the Washington Convention on the Settlement of Investment Dispute between States and National of Other States[13].

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1. Partners at Szecskay Attorneys at Law, Budapest, Hungary (orsolya.gorgenyi@szecskay.hu and andras.laszlo@szecskay.hu).
2. Act CXXXIV of 2012 on the Pressing Back of Juvenile Smoking and the Traffic Regulation of Tobaccoinst's Wares in Small Trade.
3. Act XCVIII of 2006 on the General Provisions Relating to the Reliable and Economically Feasible Supply of Medicinal Products and Medical Aids and on the Distribution of Medicinal Products (The related paragraphs are effective from 1st January 2011).
4. Act IL of 1991 on Bankruptcy Proceedings and Liquidation Proceedings (The related paragraphs are effective from 4th August 2011).
5. Act CC of 2011 on National Mobile Payment System.
6. Act CXCIV of 2011 on the Economic Stability of Hungary.
7. Act CLXXXV of 2012 on Waste and Act CXXV of 2013.
8. Act CCIX of 2011 on Water Public Utility Service (The related paragraph is effective from 14th July 2012).
9. Act LIV of 2013.
10. Act XXVI of 2006 on Strategic Stockpiling of Natural Gas (The related paragraphs are effective from 28th December 2012).
11. Goldman's Top Ten 2014 Market Themes submitted by Tyler Durden on 11/20/2013; http://www.zerohedge.com/news/2013-11-20/goldmans-top-ten-2014-market-themes
12. Guest post: differentiation is the watchword in emerging markets, by Nicholas Spiro, Aug 9, 2013, http://blogs.ft.com/beyond-brics/2013/08/09/guest-post-differentiation-is-the-watchword-in-emerging-markets/#axzz2neCep0mB
13. For example, the first privatization of the Budapest Airport in 1995 was followed by a quasi nationalization and ended in a procedure before ICSID where the investors win in 2006 against Hungary.

COUNTRY UPDATE ON INDIA

Mergers & Acquisitions and Joint Ventures: The India Story

By H. Jayesh, Senior Partner, Juris Corp, Mumbai, India (jayesh.h@jclex.com)

From daily front page news of large ticket acquisitions and investments in India by foreigners to not even once a week, is a story. This article is not about that. This article is about how we see 2014!
The reasons are manifold and not all of them have changed or been addressed; some which have or are starting to be worth talking about. The rapid run on the Indian Rupee has not only ended; it has reversed. This is seen as a function of the steps taken by the new Governor of the Indian Central bank: Dr. Raguram Rajan of Reserve

Bank of India. Dr. Rajan being appointed to this office is itself a big factor. Not because he is the former Chief Economist of the World Bank, not because he had foreseen the impending failure of the Western banking model, rather, because he is seen as a man of this century and not bogged down by ideologies. Further, his appointment, being a departure from the traditional mould, was viewed by the markets as the Indian Government being serious about doing what it takes.

In this backdrop, let's see some trends.

Multi-Brand Retailing

The first foreign investor is: no NOT Walmart! Bharti Enterprises and Walmart announced that they were parting ways for operations in the Indian retail sector and as a part of the arrangement; Walmart is buying out the Indian partner from their wholesale cash and carry joint venture. Walmart has publicly expressed disappointment with the revised Indian norms for FDI in multi-brand retail i.e. chains like Walmart. These norms were announced in 2012 and were further liberalized on 22nd August, 2013. So for the last couple of months there has been skepticism even in India. Then came the front page story that TESCO is taking a large stake in Trent which operates multiple store formats in India and is owned by the TATAs.

It will not be surprising if there are tie-ups also by the Birla group and the Biyani group (owner of Big Bazaar chain and other formats). The latter, as per media reports has been struggling and has even sold some retail assets. One group which is unlikely to do a tie-up is Reliance Retail; although it has stitched up a series up of single brand tie-ups including with Marks & Spencer.

Telecom

If there is one sector in India which mirrors policy twists and turns, regulatory risks, tax controversies, cancellation of licenses and allegations of expropriation, it is Telecom!

The Empowered Group of Ministers (EGoM) on Telecom approved the 'mergers and acquisitions' (M&A) guidelines which is expected to trigger further growth and consolidation of the telecom industry in the country. As per the draft M&A guidelines, the market share of a merged entity should not exceed 50 per cent of the subscriber base. The increase of the initially proposed 35 percent ceiling on market share to an accommodating 50 percent for merged entities in a circle is seen as a move to facilitate consolidation and hence M&A activity. The EGoM in the draft M&A guidelines agreed to increase the quantum of 1,800-MHz spectrum to be put up for auctions in January, 2014 by 118 MHz i.e. 41.4 per cent as compared to its earlier proposal. Once these guidelines are cleared by the cabinet, the M&A activity in the telecom sector will get a boost with the new guidelines and will attract the foreign investors: both new and increase of stake by the existing ones. Vodafone has already announced its plan to further increase its stake in its Indian franchise.

Banking

Another sector in focus is banking. The Reserve Bank of India in a bid to attract the international banking fraternity, has issued guidelines for foreign banks to directly participate in the Indian financial sector. Foreign banks will now be allowed to set up Wholly Owned Subsidiary (WOS) in India. The policy for setting up of WOS by foreign banks in India is guided by two principles: (i) reciprocity and (ii) single mode of presence i.e. either by branch presence or by setting up a WOS. The WOS will be given an almost national treatment that will make them at par with the Indian banks and hence enabling them to participate fully in the development of the Indian financial sector. Entering Indian market as WOS is the only option for foreign banks that are (i) having complex structures, or (ii) for banks which do not provide adequate disclosure in their home jurisdiction, or (iii) banks which are not widely held, or (iv) banks located in jurisdictions that give preferential claims to depositors in such jurisdictions in winding up proceedings. Foreign banks opting for branch form of presence shall convert into a WOS as and when the above conditions become applicable to it or it becomes 'systemically important' on account of its balance sheet size in India. The issue of permitting WOS to enter into M&A transactions with any private sector bank in India subject to the overall investment limit of 74 per cent would be considered after a review is made with regard to the extent of penetration of foreign investment in Indian banks and functioning of foreign banks (branch mode and WOS). This regulatory change undoubtedly creates a conducive environment for the foreign banks to enter the India market / enhance their current presence.

Aviation

This is yet another sector which has seen some M&A activity in the past year. Earlier this year the Government of India brought in a rule change that allowed foreign carriers to own up to 49% in India's airlines. This change has made it possible for Etihad Airways to acquire a 24% stake in Jet Airways, thereby making these two airlines the first ones to benefit from this change. Although, Jet's stake sale deal with Etihad is considered to be the biggest foreign investment in aviation, this deal had to undergo rough phases due to regulatory intervention in almost every step of the deal. Jet and Etihad had to make significant changes in the deal documents in order to be compliant with the regulatory requirements of the Government of India and are still facing some issues with the Competition Commission of India as regards 'control' in the venture.
There are tax issues and controversies; whether the next government will be a stable one (elections are due in June, 2014), judicial assessment on certain licensing activities including telecom and coal are still uncertainties. Any of these creating further shocks can mar the M&A activity. Having said that, the number of existing MNCs which are increasing their stake in their listed Indian subsidiaries to the maximum permissible limit, is seen as a continuing measure of confidence in the Indian economy and its future.

Mr. Jayesh would like to thank Ms. Barasha Baruah Pathak who assisted him in writing this article.

COUNTRY UPDATE ON JAPAN

Prospects for Inbound M&A in 2014

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In many ways, Japan finally seems ripe for inbound investment via M&A. While inbound M&A activity has declined substantially over the last 20 years (the so-called "lost decade(s)"), in 2013 there was a noticeable uptick in inbound investment activity and there is optimism in Japan that the upward trend will continue into 2014.

There are several factors which have lead to more favorable conditions for inbound M&A. First, as a result of the lost decades there has been an almost stealth like fundamental repositioning of the laws, rules and incentives faced by Japanese companies that affect their predisposition to inbound M&A. One of the more noticeable changes has been with respect to the ownership structure of public companies. Many of the previous cross-shareholders (i.e., relationship banks and affiliated companies) have been replaced by institutional and foreign investors (in particular US hedge funds), who together own approximately 50% of the market capitalization of companies traded on the Tokyo Stock Exchange. In some respects this has put pressure on Japanese public companies to be more responsive to shareholders by taking measures to restructure or spin off unprofitable or stagnant business units. Notable in 2013 was the return of the foreign activist investor in the form of US hedge fund Third Point LLC's $1.1 billion investment in Sony Corporation, which was accompanied by a call in May 2013 for Sony to spin off its film and music business. Sony publically rejected Third Point's demands in August. However, Third Point's demands seem to have provided some incentive to restructure within Sony. In November, Sony announced that it was conducting a strategic review of its entertainment division with a goal of $100 million in expense reductions, including layoffs. In December, Sony also indicated that is seeking to reduce the number of products and business lines that it is involved with. How much of this is attributable to

Third Point's activism is difficult to say, but it cannot be merely coincidental and could portend some interesting developments in 2014.

Also important for foreign dealmakers has been the gradual improvement of the M&A infrastructure in Japan, or more specifically, the legal, regulatory, tax and accounting framework within which M&A transactions are carried out. Over the last 10 years there has been considerable change in the area of corporate law with for example, new provisions for minority squeeze outs and second step mergers - making it possible for a foreign buyer to acquire control of a Japanese public company via a triangular merger scheme. Citigroup Inc. was the first foreign acquiror to effect a triangular merger with a Japanese company through its successful $16 billion tender offer and second step share purchase for control of Nikko Cordial Corporation in 2007-2008. Since then no foreign buyer has attempted to do a similar deal involving a large Japanese target. That changed in 2013 with the $10 billion acquisition of Japanese semiconductor maker Tokyo Electron Ltd. by Applied Materials Inc. of the US via a stock for stock merger. By almost any standard, the deal is somewhat complicated from a structural perspective as it creates a new merged company incorporated in the Netherlands, with joint headquarters in the US and in Japan. Under the terms of the merger agreement (or more specifically the "Business Combination Agreement"), the CEO of Applied Materials will be CEO of the merged company, while the current CEO of Tokyo Electron, will be chairman. The 11 person board will have five directors from each company's incumbent board, plus one to be mutually agreed on. A dual listing on the NASDAQ and the Tokyo Stock Exchange is planned. While publically presented as a "merger of equals" by the two companies, the deal essentially is the takeover of Tokyo Electron by Applied Materials since the shareholders of Applied Materials will own approximately 68% of the new company. The complicated nature of Applied Materials - Tokyo Electron "merger" will put the new and improved M&A infrastructure in Japan to a bigger test than the Citigroup - Nikko deal, but more importantly it may be a harbinger of things to come in 2014 and it could help in the development of a broader market for foreign takeovers in Japan.

Another factor in the improving inbound M&A outlook in Japan seems to be more attitudinal and cultural as opposed to any specific changes in the legal or regulatory landscape. For years the Japanese business and political establishment has viewed foreign takeovers of Japanese companies or spin offs of businesses to foreign buyers as complete anathemas. The sale of a significant Japanese company to a foreign buyer was acceptable only if the target was in financial distress. Yet in some cases where the distressed company was in a strategic industry, the Japanese business and government establishment would "circle the wagons" and create an entirely domestic rescue transaction, avoiding any foreign involvement. An encouraging example of the change in corporate and political mindset is Panasonic's sale of its health care business to Kohlberg Kravis Roberts in 2013 for approximately $1.7 billion. Selling to a foreign private equity firm has always been controversial in Japan, so this was a landmark deal in a way. What is more remarkable about the Panasonic - KKR deal is that KKR was thwarted by the Japanese establishment in its attempt in 2012 to acquire Renesas Electronics Corporation, a distressed Japanese semiconductor company which is the world's largest supplier of flash microcontrollers. In lieu of the KKR bid, Renesas was acquired by a consortium of Japanese corporates, including many customers of Renesas, and the Innovation Network Corporation of Japan, a government backed investment fund. While the Panasonic - KKR deal is truly noteworthy and may portend more deals in 2014 involving foreign private equity buyers in Japan, it should also be noted that Panasonic is engaged in a significant restructuring: in 2012 it canceled its dividend for the first time in 60 years and more recently announced plans to eliminate up to 50% of the workforce in its semiconductor business - 7,000 employees - by March 2015. Panasonic's restructuring would have been shocking news years ago, but the restructuring effort also makes Japan more attractive to foreign buyers as it indicates that Japanese companies are finally getting serious about restructuring to maintain competiveness.

Despite the generally positive notoriety of the Panasonic - KKR deal and its implications for foreign private equity in Japan, it may be premature to hope for a private equity boom in 2014. In December the Osaka municipal government blocked a $755 million bid by US based Lone Star Funds to acquire a local commuter rail line. The general understanding is that local lawmakers were reluctant to sell public facilities, such as railways, to short-term financial investors. So while the outlook for inbound M&A in Japan generally looks good, foreign buyers need to keep in mind the old adage, “the more things change, the more things remain the same”.

COUNTRY UPDATE ON LITHUANIA

Updates from Lithuania

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<u>2013 overview</u>

In 2013 the Lithuanian M&A market has shown a positive trend. The number of Lithuanian companies as target companies in M&A transactions has increased in 2013 in comparison with 2012. The total value of completed M&A transactions during 2013 was equal to approx. EUR 850 million. However, approx. 90% of this value is constituted from the transaction when assets and liabilities of Ūkio bankas (the bank in insolvency) were transfered to another existing bank in Lithuania. The latter deal increased the value of Baltic M&A value in general, which is total to approx. EUR 1 billion in 2013.

Lithuania was looking attractive to various investment funds in 2013 as well. IT industries and mostly IT startups were the interest of investors and business angels. It is important to note, that wealthy private investors were active in the Lithuanian market. On the second half of the year of 2013, two new funds were established – one of them private equity fund Livonia, which under the publicly available information will boost the economy with EUR 85 million investments within the upcoming 5 years, and venture capital fund Nextury, which has been established by Lithuanian investor Ilja Laurs.

<u>Trends in 2014</u>

Because of mentioned trends of activity in private equity funds and venture capital funds in 2013, the Lithuanian market expects the increase of volumes of M&A transactions in 2014 in comparison with 2013. However, what regards the value of M&A transactions it is doubtful that it will reach 2013 level. Looking to the activity in the market, it could be expected only some big M&A transactions of Lithuanian companies.

Especially such sectors like IT and manufacturing is showing potential to be at the top list as areas of interest for investors. IT services in Lithuania are highly valued, because of the quality of results provided by the IT companies and pretty reasonable costs of maintenance (taxes, salaries, etc.).

Noteworthy, that such manufacturing companies which were established 15-20 years ago and are owned by families could be also at the top “want list” in the market. Many Lithuanian manufacturing companies are rapidly approaching a time when a generational transition is necessary. Therefore, Lithuanian market is showing some good signs of recovery after the world economic crisis from the side of investors approach and attention. So, the volume of deals has good potential to rise.

Startups, which major part in Lithuania is comprised of IT startups could also be an interesting object of investment in 2014. However, it is doubtful that the value of investment to startups, especially in IT sectors will increase substantially.

Therefore, Lithuanian companies, especially manufacturing and IT companies stays at the top list of potential deals. Although financial analysts show that M&A market will rise in Lithuania, the feeling that potential seller side is quite conservative stays. Feeling the growth of the Lithuanian economy in general hopefully conservative companies' shareholders' who have been thinking about the investments, sale of business to make courageous decisions in the second half of the year.

COUNTRY UPDATE ON SPAIN

Key drivers to making deals in Spain

By Rick Silberstein, Partner, Gómez-Acebo & Pombo Abogados, Barcelona, Spain (silberstein@gomezacebo-pombo.com) and Isabella Galeano, Associate, Gómez-Acebo & Pombo Abogados, Barcelona, Spain (igaleano@gomezacebo-pombo.com)

There is evidence of reactivation in the M&A market. The crisis has reshaped the M&A perspectives in Spain and new drivers appear to motivate this incipient upturn. What is currently making Spain an attractive M&A market? The Spanish government has put in place a number of measures regarding the labor market, entrepreneurship and foreign investment in order to stabilize the economy and overcome the downturn. These new regulations are proving effective in rebuilding investors' confidence. International investors are back attracted by interesting possibilities offered by a Spanish market where there are many high quality assets burdened by debt. What sectors are likely to promote the most interesting deals? 2013 has been the starting point of an increasing trend of successful deals, to a large extent in the banking industry. A sector directly incentivized by the government to concentrate in order to gain competitiveness and financial strength. The most recent transaction is the sale of the bank bailed out by the government, NovaCaixaGalicia, to the Venezuelan bank Banesco for €1,000 million.

Good assets are coming onto the M&A market as companies slim down in order to focus on their core business. The economic situation has forced many companies to redefine their strategic activities. Therefore they are selling either stakes or businesses that are not directly involved with their main business, bringing onto the market investment opportunities for those willing to buy or take control of Spanish companies. A significant example is the intention of La Caixa, the third biggest Spanish financial entity, of selling its important minority stake in Gas Natural.

Price, of course, is one of the most determining factors for international investors. American and Asian firms appear especially eager to acquire renowned brands, technologies, expertise, or a skilled work-force at attractive prices. Investors are looking for low prices and high yields but this gap may become smaller as the credit flows go back to the companies and the urge for alternative financing decreases. This would favor those investors who have a more long term approach.

Some investors express concerns about the difficulty of making realistic valuations and the possibilities of recovering their investments if the lack of economic growth persists. Asset valuation can play a major role as a deterrent for investors just as good prices can be the best incentive. However, we have identified a shift in the focus of a number of investors whose drivers are set on building strategic alliances.

The Spanish banking industry and others such as the energy sector that have been strongly hit by the economic turmoil and changing regulation are facing the need to merge in order to survive. M&A is not regarded exclusively as a way to gain market share or to expand, but is becoming the road to survival. Reducing costs, increasing synergies that make business more profitable, penetrating new markets otherwise inaccessible, acquiring know-how or enhancing product development are the benefits sought by companies operating and investing in Spain.

The current circumstances also increase risk awareness and make deals more complex. Investors are more cautious, undertake greater due diligence and request stronger contractual protections.

We see an increasing demand to assess new kinds of risks such as political and reputational risks. While Spain offers a stable, reliable and flexible regulatory framework, clients inquire about government positions. We are commonly asked to foresee regulators' intentions. This is especially significant in the energy sector.

These set of risks, now assessed in detail, are having a great impact on the timing of transactions. Appetite is back, but investors take a much longer time to examine issues and close transactions. Fast-moving M&A activity is far from being back. The fact that many of the attractive investments are sold through judicial procedures controlled by bankruptcy courts adds to dragging out the closure of transactions. Judicial auctions commonly suffer delays due to the overload of Spanish judicial system.

The government is intensely promoting across all economic sectors the internationalization of companies regardless of their size. Companies are seeking to compensate the weakened internal demand with strategic acquisitions to penetrate high growth markets or, otherwise, to incorporate leading assets that will enable them to stay competitive.

In the last few months Spanish companies have bought outside businesses amounting to more than €13,300 million. Pharmaceutical and telecommunications are amongst the most active sectors. A good example is the €8,550 million acquisition of E-plus, KPN's German subsidiary dealing with mobile phones carried out by Telefonica. Grifols among other investments has acquired the Novartis diagnostic division for €1,240 million. Almirall has acquired Aqua Pharmaceuticals for $305 million. In sum, 2014 seems a year for moderate optimism, where Spain will be able offer investors' good quality business at interesting prices.

COUNTRY UPDATE ON THAILAND

Thai M&A Trends in 2014: Approaching ASEAN Integration

By John Frangos, Senior Associate, Limcharoen, Bangkok, Thailand (john@limcharoen.com)

By 2015, the countries that comprise the Association of Southeast Asian Nations ("ASEAN") are set to establish an economic block known as the ASEAN Economic Community ("AEC"). The AEC aims to achieve regional economic integration amongst the ASEAN states by, among other things, developing a single market and production base. As such, a legal framework is being developed to allow the free flow of goods, services, investment, skilled labor, and the freer flow of capital within the ASEAN region. As the AEC draws nearer, it is likely that Thailand, the second-largest economy within the ASEAN region, will see an increase in M&A and joint venture activity in 2014.

A fundamental component of the AEC is the removal of trade and investment barriers (with certain limitations). As such, non-Thai investors from other ASEAN countries are expected to bring greater competition to the Thai market. Thai enterprises, both large and small, will likely seek to strengthen their positions by acquisitions and joint ventures to prepare themselves for the expected increase in foreign competition. Such activities will likely include domestic, outbound, and inbound deals.

Regional Players

Acquisitions of targets in external ASEAN markets by Thai companies would help enable such businesses to quickly become "regional". These acquisitions would provide the acquiring company new revenue streams, international visibility, and greater access to new markets and resources. Furthermore, such outbound acquisitions would serve to preclude other domestic Thai competitors from gaining footholds in non-Thai ASEAN markets.

What is more, outbound acquisitions will have added appeal if the foreign target is also a potential competitor in the domestic Thai market. This trend has already begun in 2013, when Thai Beverage PCL (owner and distributor of Chang beer, among other brands) acquired Singaporean competitor Fraser and Neave Ltd. The deal provides Thai Beverage a strong position in the Singaporean, Malaysian, and Thai markets in advance of the AEC.

Domestic Deals

Domestic acquisitions and joint ventures are also likely to increase in 2014. Such deals have the potential to strengthen Thai companies' ability to compete with foreign entrants into the Thai market as a result of the AEC. An example of such a transaction, also from 2013, is the acquisition of Siam Makro PCL, a popular cash and carry retailer, by CP All PCL, the sole operator of 7-Eleven stores in Thailand (among other things). The end result is a larger Thai company that is in a stronger position to compete with other ASEAN-based retailers seeking to expand into the lucrative Thai market.

Inbound Transactions

Many of the same competition-related factors are likely to motivate other ASEAN-based investors to seek deals in Thailand. As such, inbound acquisitions and joint ventures are also expected to increase in 2014. Non-ASEAN based investors are also likely to join this trend. Thailand can be used as a staging ground to implement other ASEAN-based investments once the AEC comes into force. Thailand's developed physical and financial infrastructure, central location, and generally favorable investment conditions make it a good location for such a strategy.

Uncertainties

While many Thai companies will likely seek out new deals in 2014 to prepare for the AEC, some will undoubtedly encounter challenges. Though the AEC aims to achieve a single economic market, the member-states of the ASEAN region are politically, culturally, and linguistically diverse. Despite close geographic proximity, many Thai (and foreign) companies may lack knowledge about the market that they are entering. Strategies that may have worked in home countries may not be as successful abroad. As a result, thorough due diligence and market research is vital to success.

Additionally, it is still far from certain as to how the AEC will be practically implemented. Many changes to ASEAN countries' domestic laws will be required to realize the AEC's goals. Such changes will be politically difficult to achieve in many cases. However, even if the AEC does not come to fruition as planned by 2015, the march towards integration will continue, albeit at a slower pace. It is therefore still highly likely that M&A and joint venture activities will continue to increase in Thailand and across the ASEAN region over the coming years.

COUNTRY UPDATE ON THE NETHERLANDS

Cross-border corporate conversions involving the Netherlands

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Introduction

Both inbound and outbound company conversions involving the Netherlands are becoming popular lately, and we expect this to continue in 2014. A trend in European Court of Justice (ECJ) case law[1] shows that the ECJ considers the blocking by a member state of a cross border company conversion, while allowing conversions domestically, a prohibited infringement of the freedom of establishment within Europe. Consequently, inbound and outbound company conversions are possible restructuring tools. This makes European companies much more versatile. If a company wants to transfer its business to another country within the European Economic Area (EEA), it is generally no longer necessary to liquidate the company and transfer the assets and liabilities to a new company or existing group company in another country, or to transfer the effective management only (without changing the legal personality of the company). As a result of a cross-border corporate conversion, the applicable law to the company changes without interrupting the legal personality of the company. A cross-border conversion involving the Netherlands is possible within the EEA and is generally also possible with a country outside the EEA if the conversion is done indirectly (through a country that allows for a conversion outside the EEA) and the third country involved facilitates the conversion.

Corporate procedures

In respect of cross-border conversions no European procedure is currently in place, but it has been announced to be in the making[2]. Dutch law also does not contain provisions on cross-border conversions. However, currently corporate conversions can be realized by closely following and combining the legal procedures for among others conversion in the country of entry and the country of departure. This means that the relevant corporate documents in both countries involved need to comply with all the applicable requirements. Close coordination with legal advisors of all relevant jurisdictions is required to make sure the conversion is done properly. If a conversion involves the Netherlands, a notarial deed of conversion to be executed before a civil-law notary in the Netherlands is required. Furthermore, in the conversion procedure the interests of minority shareholders, creditors and employees must be taken into account.

Taxation

Conversion in itself is not a taxable event for Dutch corporate income tax purposes. However, the migration of the fiscal residency usually is. Fiscal residency is in many cases determined by the place of effective management and often a cross-border conversion will imply a change of the place of effective management of the converting company.

In case of an inbound conversion to the Netherlands, where a company becomes a Dutch resident pursuant to a change of residency, it will in principle have to re-value its assets and liabilities to market value (step-up or step-down) to determine the starting balance for Dutch corporate income tax purposes. There is no step-up for Dutch dividend withholding tax purposes, but a practical solution may provide a step-up prior to immigration. In the case of an outbound conversion, where a company would generally cease being a Dutch resident, an exit levy of all hidden reserves and goodwill would in principle follow. However, a mere holding company can generally apply the Dutch participation exemption for Dutch corporate income tax purposes which in practice often means that no tax is due. For Dutch dividend withholding tax purposes, an outbound conversion is not a taxable event.

Incentives for cross-border conversions

Incentives for cross-border conversions can be numerous. In our experience possible incentives include the wish to eliminate certain jurisdictions in a corporate structure to be able to apply a different tax treaty network. Or there may simply be a practical corporate reason to convert. Netherlands outbound conversions have for example involved the conversion of a Dutch B.V. firstly to a Luxembourg entity and subsequently to an entity outside the EEA so that certain losses could be set off. In respect of Netherlands inbound conversions we have for instance seen the conversion of a Cypriot entity into a Dutch B.V. to smoothen the process in a capital markets transaction.

In case of a (cross-border) company conversion, in principle no transfer of assets or liabilities takes place and change of control provisions included in contracts are generally not triggered. This makes converting a company in many ways more appealing than liquidating the company and having to set up a new company, or transferring the effective management only. A cross-border company conversion, if done properly, does not lead to dual tax residency.

All parties involved in international restructurings should consider adding the cross-border conversion as a practical tool to their restructuring work kit.

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1. Daily Mail (C-81/87), Cartesio (C-210/06) and Vale (C-378/10).
2. http://eur-lex.europa.eu (COM/2012/0740 final).