McDermott Will & Emery

ISSUE 2 2016

IN
International News

FOCUS ON

International M&A

The Impact of The EU General Data Protection Regulation

The Rising Popularity of M&A Transactions in the Life Sciences Sector

The Impact of CIFUS Reviews on M&A Transactions

McDermott Will & Emery

IN International News

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2015 and 2016 have been interesting years for the M&A markets. In life sciences, closed deal values for 2015 were almost twice as much as in 2014. In energy, 2015 resisted accepted wisdom that M&A activity rises in correlation with a decline in crude oil prices and waiting till now for an upturn in energy M&A activity.

The markets still face major challenges. For example, international acquisitions often require the navigation of multiple legal regimes to achieve their integration goals such as the rationalisation of outsourcing contracts, which are usually the highest cost vendor contracts in a company and need to be carefully examined to ensure they are fit for purpose and do not generate any additional costs. Transactions involving the acquisition of US entities by foreign entities may need to be reviewed by the Committee on Foreign Investment in the United States, which determines if a US national security interest is impacted.

Of course, life also goes on elsewhere. The introduction of the EU General Data Protection Regulation and the UK Government's new cap on interest deductibility are both looming and require attention.

Please contact me if you have any comments on our articles or would like to discuss any of the issues raised.

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The Impact of The EU General Data Protection Regulation

PAUL MELOT DE BEAUREGARD, MÉLANIE BRUNEAU, ANN KILLILEA, MAX BAUR AND ANTOINE DE ROHAN CHABOT

The EU General Data Protection Regulation 2016/679 will apply as of 25 May 2018, at which point it will replace the current legal framework. CONTINUED >

The EU General Data Protection Regulation 2016/679 (GDPR) was published in the Official Journal of the European Union on 4 May 2016 following the compromise agreed among the Council of the European Union and the European Parliament.

It is intended to replace the EU Data Protection Directive 95/46/EC (Data Protection Directive), which was adopted in 1995 when the internet was in its infancy. Given the rapid and significant development of digital technologies and their effects on personal data, the Data Protection Directive needed updating and modernising. In addition, its transposition in the national legislation of all EU Member States has sometimes created obstacles to effective and consistent implementation across the European Union.

> "The GDPR will essentially affect any business coming into contact with European personal data."

Against this background, the GDPR is intended to strengthen online privacy rights, boost the European digital economy and harmonise the regulatory environment for businesses. Notably, since the GDPR is adopted in the form of an EU regulation, it will have direct and immediate effect in all EU Member States.

KEY FEATURES OF THE GDPR

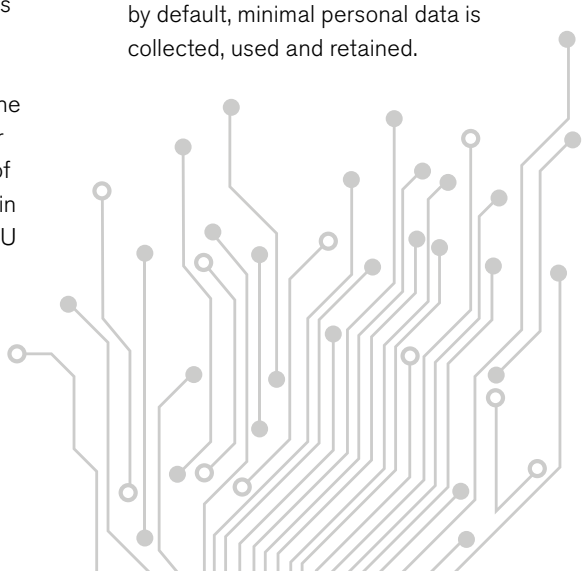
Businesses already established in the European Union or the European Economic Area (EEA) should assess and adapt their current procedures and policies in order to comply with the GDPR. The implementation of the GDPR will, however, require broader changes in the business practices of non-EU companies doing business in the European Union and handling EU personal data.

The GDPR's main changes include the following.

Extended territorial reach: The territorial reach of the GDPR will extend beyond the European Union and the European Economic Area; a company outside the European Union targeting consumers in the Union will be subject to the GDPR. It will essentially affect any business coming into contact with European personal data, where the data processing is either related to the offering of goods or services (including those that are free) to the data subjects in the European Union and the European Economic Area, or where the behavior of the EU/EEA data subjects is monitored.

This extended territorial reach will affect every entity and individual doing business with the European Union and the European Economic Area, even if they operate from a non-EU/EEA country, notably if their website is accessible from the European Union and the European Economic Area. For example, collecting IP addresses in access logs, or tracking visitors using cookies or using javascript will trigger the application of the GDPR.

Privacy by design and privacy by default: Companies should take privacy risk into account throughout the process of designing a new product or service, and adopt mechanisms to ensure that, by default, minimal personal data is collected, used and retained.



Harmonisation: A single, unified set of rules on data protection will be valid across the European Union and the European Economic Area and certain administrative requirements, such as notification requirements for companies, will be removed.

Governance and data breach notifications: Responsibility and accountability for companies processing personal data will be increased. Data controllers and processors will need to keep a written record of the processing activities carried out and any processing of personal data should be lawful, fair and transparent. Companies must notify the national supervisory authority of serious data breaches without undue delay, where feasible within 72 hours.

One-stop shop: Companies will only have to deal with the national data protection authority (DPA) in the EU country where they have their principal establishment. Businesses not established in the European Union or the European Economic Area will be required to designate a representative in the European Union and the European Economic Area, unless their data processing under the GDPR is only "occasional". Where the Data Protection Directive required a representative for each relevant Member State, a single representative will be sufficient under the GDPR.

Active consent: The GDPR requires a more active consent-based model to support lawful processing of personal data; wherever consent is required for data to be processed, it has to be given explicitly and not assumed. In addition, a data subject's consent to the processing of its personal data must be as easy to withdraw as it is to grant. If personal data is processed for direct marketing purposes, the data subject will have a right to object, which must be explicitly brought to its attention.

Specific rules regarding consent may be adopted by EU Members States in employment contexts.

Data Portability: Data subjects will have easier access to their own data and will be able to transfer personal data in a machine-readable format that can then be transferred (ported) to a new service provider more easily (right to data portability).

Right to be forgotten: Data subjects have a right to be forgotten. They will be able to delete their data if there are no legitimate grounds for retaining it, even where the data has previously been made public.

Stronger enforcement: The powers of the independent national data protection authorities will be strengthened to better enforce EU data protection rules in the EU Member States. They will be empowered to fine companies that violate EU data protection rules, with penalties of up to €20 million or up to 4 per cent of the global annual turnover of a company for the preceding financial year (whichever is higher). This is, however, the upper limit for the most extreme and severe violations of the GDPR, and does not imply that the fines imposed in average cases will actually increase.

Data Protection Officer (DPO): The designation of a DPO will be compulsory where the main activities of a company consist of i) processing data subjects on a large scale which, by its nature, scope or purposes, requires regular and systematic monitoring; or ii) processing of special categories of data on a large scale. In other situations, a DPO may be appointed by the controller or processor on a voluntary basis, or where required by the laws of an EU Member State.

Data transfers: The rules relating to data exports to non-EU/EEA countries will not change significantly because they were already harmonised under the Data Protection Directive. Data transfers will continue to be allowed where the European Commission has established that the level of data protection in the destination country is adequate, and will remain prohibited to third countries that do not ensure an adequate level of data protection, unless i) appropriate safeguards are provided, or ii) one of the derogations specified in the GDPR is available.

Appropriate safeguards will continue to include EU Model Clauses and Binding Corporate Rules. The revised rules regarding data transfers to the United States are also the subject of the EU–US Privacy Shield, which will now replace the Safe Harbor Program, which the European Court of Justice ruled was invalid.

THE IMPACT OF BREXIT ON DATA TRANSFERS BETWEEN THE EUROPEAN UNION AND THE UNITED KINGDOM

The situation will depend on the exit agreements that the United Kingdom reaches with the European Union, and the United Kingdom's status after it leaves the European Union.

For the purposes of data protection laws, if the United Kingdom remains part of the European Economic Area, opting for the same status as Norway, Iceland and Liechtenstein, there are likely to be limited changes in the area of data protection. Both the current Data Protection Directive and, later, the GDPR, would apply to the United Kingdom.

However, if the United Kingdom were to leave the European Union / European Economic Area, it would be considered a "third country" for the purposes of EU data protection laws, even if it gained access to the Single Market through bilateral agreements as Switzerland does. Under this scenario, we expect that, initially, UK data protection laws would still comply with EU law and transfers of personal data to the United Kingdom could be based on an adequacy decision of the European Commission under the Data Protection Directive or the GDPR.

Companies handling EU/EEA personal data moving to or from the United Kingdom will, however, have to re-evaluate their current arrangements and may consider relocating their operations to the EU.

In the meantime, however, the United Kingdom's national legislation implementing the Data Protection Directive will continue to apply.

NEXT STEPS

The GDPR will directly apply in all Members States on 25 May 2018. Until then, current national legislations implementing the Data Protection Directive will remain in force.

It is advisable for companies to use the next two years to examine their existing processes and procedures and to review their data privacy policies to ensure compliance with the GDPR before it becomes applicable.

It is expected that the national data protection authorities and the European privacy bodies will issue guidelines and opinions in the following months to assist organisations with their preparation.

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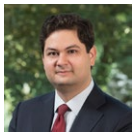

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UK Government Confirms Introduction of New Cap on Interest Deductibility

MATTHEW HERRINGTON

The UK Government is introducing a new cap on interest deductibility, with effect from 1 April 2017. This leaves affected groups very little time in which to consider the rule's impact and to refinance their existing arrangements.

Under the new rule, the ability of groups to obtain tax relief for interest will be limited by reference to a ratio of their net interest expense to earnings before interest, taxes, depreciation and amortisation (EBITDA).

The new restriction is intended to operate alongside the various transactional-based restrictions already present in the UK tax code, such as the transfer pricing, distributions and unallowable purpose rules. The new restriction will in principle apply to both external and intra-group debt, so will not be precluded from applying solely by virtue of the fact that the interest in question accrues on debt advanced by a third party lender.

The government is currently consulting on the detailed design of the new restriction, and intends to publish legislation later this year for inclusion in the Finance Bill 2017.

THE PROPOSED RESTRICTION

The proposed restriction has the following key features, and will apply on an accounting period-by-accounting period basis:

- A fixed ratio rule (FRR), limiting UK tax deductions for net interest to a maximum of 30 per cent of a group's tax-adjusted UK EBITDA.
- An optional group ratio rule (GRR), which a group can apply in place of the FRR and which allows tax relief for interest to be calculated by reference to the group's net interest to EBITDA ratio.
- A £2 million threshold, whereby the new restriction will not apply to groups whose net UK interest expense does not exceed £2 million in any given accounting period.
- The ability to carry forward spare borrowing capacity from one accounting period to the next for up to three years, and the ability to carry forward restricted interest indefinitely.

> "The FRR will be applied on a group-wide basis, rather than on a company-by-company basis."

- A modified worldwide debt cap rule, which will apply in addition to the FRR and/or GRR, and which is intended to ensure that groups with low levels of external debt cannot leverage up their UK operations to the FRR limit.
- Targeted anti-avoidance rules aimed at preventing the circumvention of the new restriction.

Critically, there are currently no proposals for existing debts generally to be grandfathered. This means that existing financing arrangements in place with portfolio companies as at 1 April 2017 will generally be within the scope of the new rule, at least in relation to interest accrued on or after that date.

THE FRR

Group Concept

The FRR will be applied on a group-wide basis, rather than on a company-by-company basis. For the purposes of the FRR, the definition of a "group" will be based on accounting concepts. In essence, a group will comprise the "ultimate parent" (generally the top level holding company in a corporate structure), together with all companies that would be consolidated on a line-by line basis into the consolidated accounts of the ultimate parent.

Definition of "Interest"

The concept of "interest" is extended by the FRR to comprise all payments that are economically equivalent to interest, as well as expenses incurred in connection with the raising of finance. This means that "payments in kind" will have to be taken into account when applying the FRR, as will related payments, such as guarantee fees.

In applying the FRR, it is, however, only the net interest expense position that matters, as financing income amounts (such as interest received) are netted off of financing expense amounts in order to reach a net position. It is the net position that is, in principle, subject to the FRR restriction on deductibility.

Interaction with Other Parts of The UK Tax Code

The FRR is intended to apply after almost all other parts of the UK tax code have been considered, including the UK transfer pricing rules. This means that affected groups may still suffer a restriction on interest deductibility even if they have agreed with HMRC that the interest in question is arm's length under an Advance Thin Capitalisation Agreement.

In addition, the government has indicated that a modified debt cap rule will apply alongside the new FRR. This rule is intended to prevent groups that would not otherwise have high levels of external debt from leveraging up their UK operations to the FRR limit. In essence, the rule will "cap" the amount of UK net interest that a group can obtain tax relief for by reference to the net external interest expense of the group.

The modified debt cap rule will need to be considered in addition to the FRR itself, which in turn will need to be considered after the application of the more transactional-based restrictions in the UK tax code, such as the transfer pricing rules.

CARRY-FORWARD RULES

The government is proposing that interest that is restricted under the FRR should be eligible for carry-forward to future accounting periods indefinitely. This should mean that if there is sufficient capacity in those future periods, the carried-forward amount should become deductible, and should therefore be eligible for tax relief.

The government is also proposing that unused borrowing capacity (calculated by applying the borrowing limit under the FRR) from one accounting period be eligible for carry-forward for up to three future accounting periods.

These aspects of the rules will be helpful in mitigating the impact of the new rules on earnings volatility across multiple accounting periods of portfolio companies.

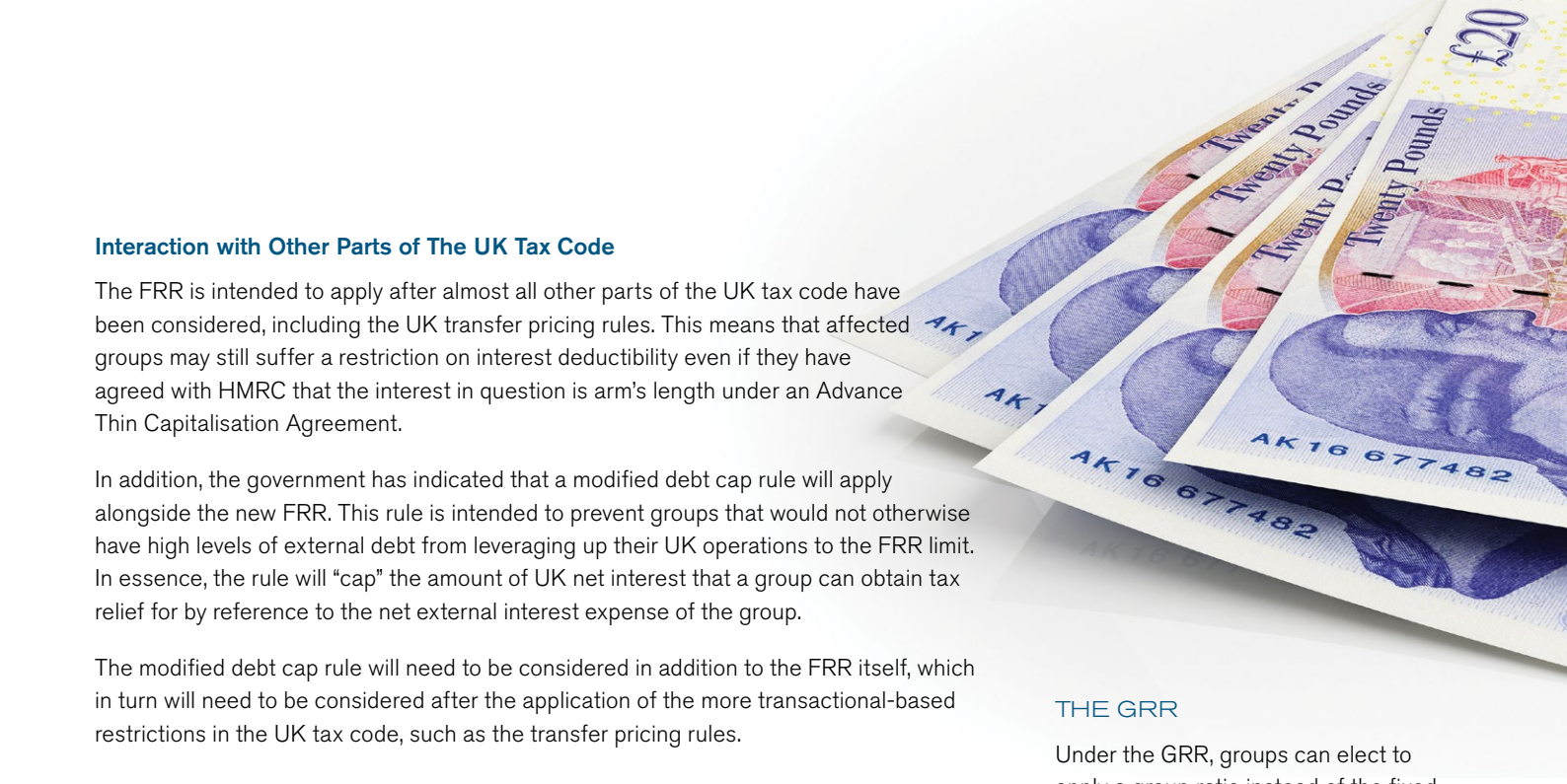
There are, however, no proposals to allow the carry-back of interest that is restricted, or of unused borrowing capacity, which is disappointing. In addition, the ability to carry-forward excess interest deductions may ultimately not be of any value in view of the forthcoming wider changes on the carrying-forward of losses (the CFL Rules), which were announced in the Budget in March 2016 and which are also expected to come into force on 1 April 2017.

The CFL Rules will limit the amount of profit that can be sheltered using carried-forward losses, such that only 50 per cent of profits in excess of £5 million can be sheltered. At present, the government intends that

- Carried-forward losses from before 1 April 2017 will not be subject to the FRR, but will be affected by the new CFL Rules.
- Interest that arises on or after 1 April 2017 and which is affected by the FRR will not be subject to the CFL Rules.
- Losses arising after the application of the FRR will be subject to the CFL Rules.

THE BASIC EFFECT OF THE 30 PER CENT FRR RULE AS PROPOSED BY THE UK GOVERNMENT

Taxable EBITDA	£600 million
Net interest expense	£200 million
Net allowable interest	£180 million
Interest restricted	£20 million



THE GRR

Under the GRR, groups can elect to apply a group ratio instead of the fixed ratio that applies under the FRR. The GRR is entirely optional, and the UK Government expects it to benefit only a small proportion of groups.

The GRR is aimed at groups that are highly leveraged for commercial reasons, and allows them to obtain tax relief for net interest deductions up to a limit in line with the group's overall position. As such, the GRR is a welcome feature of the new rules that should go some way to mitigating their impact on groups whose funding structures do not present base erosion and profit shifting risks.

NEXT STEPS

The FRR will generally have no grandfathering, and will apply from 1 April 2017. All affected groups should urgently consider the ramifications of these forthcoming changes and the possible need to refinance their existing funding arrangements.

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Listed Companies: Dealing with Reporting Obligations in the Context of Antitrust Proceedings

LIONEL LESUR AND LOUISE ABERG

Antitrust proceedings usually trigger an obligation of disclosure for listed companies, which may be problematic given their confidential nature.

Financial regulatory authorities such as the US Security and Exchange Commission (SEC) and the French *Autorité des marchés financiers* frequently impose on companies that are listed on a stock exchange the obligation to disclose key information to investors to help them make informed investment decisions.

The difficulties for companies lie principally in the nature of the information to be disclosed, the timing of the disclosure, and the balance of the obligation towards financial regulatory authorities on one hand, and competition authorities on the other.

For example, the launch of a procedure for an alleged antitrust infringement is usually considered as material information for investors because, depending on the outcome, companies could end up facing significant fines and reputational harm, which could in turn have a negative impact on the value of the company's shares.

Listed companies may need to disclose antitrust proceedings as part of a periodic reporting obligation (such as the 10-K that must be filed with the SEC) or may be required to do so immediately. In the absence of guidance from financial regulatory authorities, it may be difficult to determine when the time is right to make the disclosure as there are many different steps to an antitrust proceeding.

For example, the European Commission may start by carrying out inspections at a company's premises or sending requests for information, followed by a statement of objections if the initial enquiries confirm its suspicions that an infringement may have taken place.

> "Listed companies need to be wary of their respective—often conflicting—obligations."

Companies may wish to inform investors at the earliest possible stage in order to avoid violating their obligations towards financial regulatory authorities, but this approach may conflict with the competition authorities' requirement of discretion. Specifically, companies that cooperate with a competition authority in exchange for full immunity or a reduction of their fines are, in some jurisdictions, prohibited from disclosing the fact and content of their cooperation to third parties before the competition authorities approach the other companies involved in the alleged infringement.

In some situations, it may be possible, however, to obtain the competition authority's authorisation to disclose the antitrust proceedings in order for listed companies to comply with their obligations towards investors.

In general, however, listed companies need to be wary of their respective—often conflicting—obligations towards financial regulatory authorities and competition watchdogs, and make sure they are prepared in advance on whether, how and when to communicate with investors.

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The Rising Popularity of M&A Transactions in the Life Sciences Sector

EMMANUELLE TROMBE AND RAPHAËLLE MONJOU

The overall closed deal value for 2015 in life sciences was US$402.9 billion—almost twice as much as in 2014 (US$169.3 billion)—a significant portion of which was cross-border M&A. Why has M&A become so popular in this sector?

CONTINUED >

Botox and Viagra would have made a perfect match, but the US Treasury stepped in to tighten up US tax laws and put a hold on what was expected to be the largest M&A deal in the history of life sciences and also the biggest tax "inversion" ever attempted.

This cancelled merger brought life sciences M&A into the limelight, but this was well-deserved, as 2015 was a prolific year for the sector. While 2015 was characterised by a large number of M&A deals across all industries, the life sciences sector had the largest share.

> "Two specific types of M&A transaction have seen an increase in recent years."

WHY IS M&A SO POPULAR?

There are a number of reasons why, when compared with other heavily-regulated and research-oriented sectors such as oil, gas or automotive, so many M&A deals have recently occurred in the life sciences sector.

The most obvious reason is the "patent cliff". The number of very profitable, blockbuster pharmaceutical products is diminishing as a result of key patents reaching their expiration date, which leads to decreased profits resulting from the entry into the market of generics.

Another reason is the perfect storm of new medications taking longer to develop, research and development (R&D) becoming more expensive, and the fact that new medicines often target narrower segments of population, meaning their potential market is relatively small. As a result, even if the R&D stage is successful, it is uncertain how profitable these new medicines will be.

As a result, when pharmaceutical companies find it difficult to innovate, or lack the resources to fund R&D, they buy products that are at a less risky stage. The sellers are often smaller companies that have specific expertise in R&D, but have no late stage development or commercialisation expertise, or do not have the financial capability to fund it.

TYPES OF DEALS

Two specific types of M&A transaction have seen an increase in recent years: the selective acquisition of strategic businesses and the divestiture of non-core businesses. A number of these transactions have been implemented through asset swaps.

This trend is illustrated by GlaxoSmithKline's swap of oncology assets in exchange for Novartis' vaccine division and Sanofi's contemplated trading of Merial, its animal-health unit, for Boehringer's consumer health care business.

These asset swaps often create opportunities for other transactions, for example, when divestitures are required as a clearance condition by antitrust authorities. As part of its transaction with GlaxoSmithKline, Novartis had to divest two of its late development stage immune-oncology products, Encorafenib and Binimetinib, to Array Pharmaceuticals, which in turn entered into an agreement for the development and commercialisation of these products in Europe with Pierre Fabre.

In order to refocus on their core businesses, pharmaceutical companies have also tended to outsource manufacturing and even, to some extent, early R&D, and to divest non-core programmes into spin-out companies, which may be financed by investors. These trends multiply opportunities for M&A and other type of transactions.

LICENCING AND COLLABORATION

By far the most popular transactions in life sciences, however, are still licencing and collaboration; 65 per cent of externally sourced pipeline value comes from co-development, joint ventures and licencing, while only 35 per cent from "pure" M&A.

The number of licencing and collaboration deals has dramatically increased for the same reasons as M&A deals: the patent cliff and risk sharing. Unlike M&A, collaboration and licencing transactions often allow the pharmaceutical company to retain the benefit of its partner's expertise and the ability to innovate fast. They also allow pharmaceutical companies to access expertise outside their core business, whether in biotechnology, medical devices or digital health, which is perceived as a key area of growth.

PRICE STRUCTURES

The price structure of M&A and licencing deals tends to converge in life sciences since earn-out clauses are quite common in M&A transactions.

In an earn-out structure, the ultimate price is based on the performance of the target or its assets following the closing. In life sciences, the earn-out triggers are often linked to the development or the commercialisation of the acquired products. This mechanism is intended to bridge the valuation gap between the value expected by the seller and the price that the buyer is willing to pay at any given stage of the life cycle of the product.

> "Asset swaps often create opportunities for other transactions."

>50%

of life sciences M&A deals contain earn-out provisions

This alignment is of the utmost importance considering the intrinsic uncertainty of R&D, coupled with the heavy regulatory and market access constraints, which make it difficult for the buyer to pay full price until the acquired assets are de-risked. It is therefore not surprising that more than 50 per cent of life sciences M&A deals contain earn-out provisions. This mechanism is used both in private M&A and in public M&A, in the form of contingent value rights.

Since the achievement of earn-out-triggering events depends on the management of the acquired business by the buyer, there is a risk of litigation when the buyer fails to meet the targeted performance. In most cases, the share purchase agreement states the anticipated level of diligence that is expected from the buyer in pursuing the triggering events. In life sciences, however, there are so many uncertainties out of the parties' reasonable control that it is difficult to request firm commitments from the buyer.

The compromise is often to agree on a very qualified definition of "commercially reasonable efforts" or "diligent efforts". This must take into account the level of effort and resources consistent with those used by the buyer or a similar company, for a similar product, with a similar market potential, at a similar stage in its development or product life, balanced against a number of factors, such as market exclusivity, competitiveness of alternate products, profitability and, sometimes, provisions referring to all other relevant factors.

These earn-out systems are very likely to lead to disputes as a result of their complexity and the amounts usually at stake. When disputes occur, it is often difficult to determine the damages suffered by the seller. In licencing agreements, one of the remedies for the licensee's breach of its obligation to diligently develop and commercialise the licenced product could be that the licence is terminated and the licensor obtains the product back along with all improvements generated by the licensee, so that it is able to exploit the product itself or to find a better partner. This reversion is more difficult to implement in an M&A context, where the sellers may not be willing, or have the capacity, to take the assets back.

In conclusion, despite a strong convergence between M&A and licencing, with more and more back end-loaded M&A transactions, licencing and collaboration remain the preferred methods for life sciences companies to expand their product portfolios.

Fatoumata Traore also contributed to this article.

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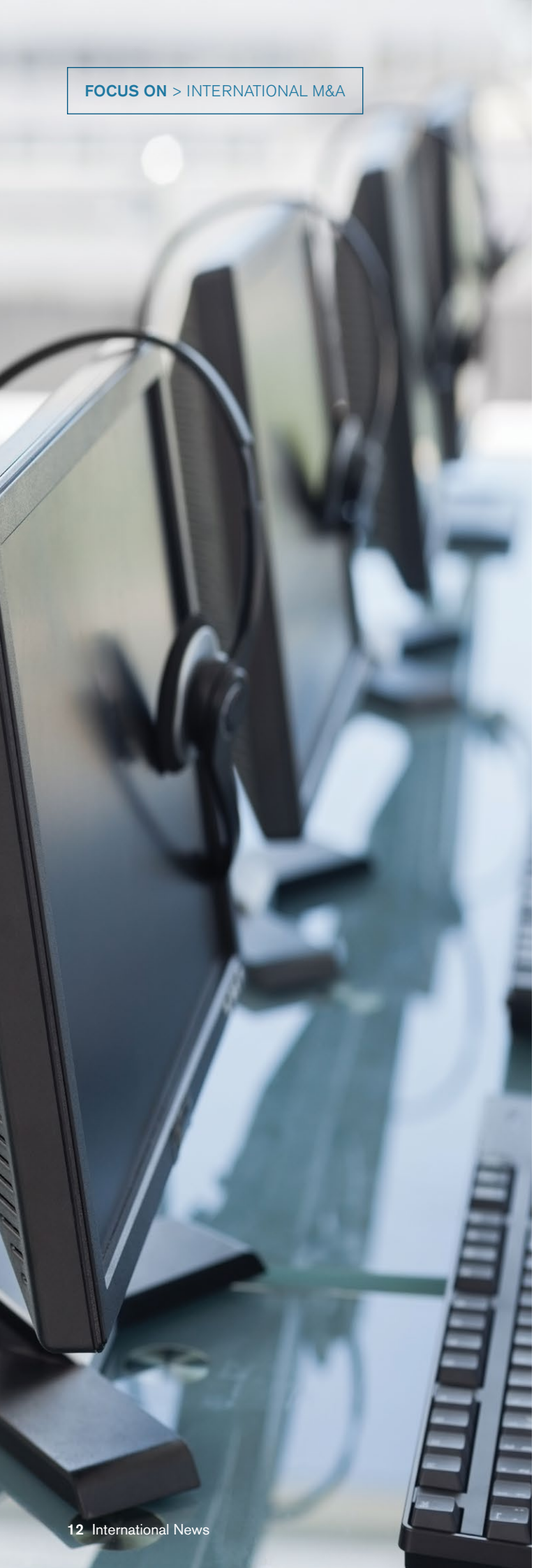

Why a Careful Review of Outsourcing Agreements is Important in International M&A Transactions

SHAWN HELMS, RALF WEISSER AND CLAUS FÄRBER

Outsourcing agreements are behind the most important vendor relationships. They therefore require a detailed review as part of the due diligence process of any M&A deal or spinout transaction.

With more and more businesses relying on outsourcing, the underlying agreements have become an important factor in M&A transactions. The services provided under an outsourcing agreement are often deeply intertwined with the entities' businesses, providing mission-critical services such as information technology services, finance and accounting, procurement, warehouse operations, payroll, software application development and maintenance, and research and development. Contracts are often multi-year commitments and are almost always the highest cost vendor contracts in a company. For these reasons, they require attention and potential revisions to make any transaction successful.

Outsourcing agreements may – just as any other major contract does – include clauses that might become harmful. These include change-of-control clauses, wide exclusivity clauses, and the restrictive termination clauses that are commonly found on due diligence checklists.

It is also vital to understand the operational obligations and scope of these agreements, as they will affect how the combined company operates going forward. This will require a careful review of the service descriptions, service levels and transformation plans stated in the outsourcing agreements.

MERGERS AND ACQUISITIONS

In mergers and acquisitions, the strategic goals of the transaction will have a major influence on existing outsourcing contracts. The intention is often that the combined entity will be able to consolidate their operations, including strategic outsourcing contracts.

Existing outsourcing agreements must be evaluated to determine if the relationship should be retained, modified, terminated or combined. Because providers often require long minimum terms, minimum volumes and high termination fees in order to recoup their initial investment, the termination or reduction of these contracts is sometimes difficult. While it may be possible to get out of a contract that has not yet reached its minimum term, this will require extensive negotiations and potentially expensive termination payments. If an outsourcing contract is to be terminated, the parties should take steps to help ensure a smooth transition of the services to another outsourcing provider or, if services are to be insourced, the surviving company.

In relation to outsourcing agreements that are to be retained, it can sometimes be a challenge to integrate new business units or affiliates. While outsourcing agreements can often be extended in scope, and subsequently used by all affiliated group companies, this will sometimes require changes to the agreement to add new service descriptions, local country agreements, or other amendments to facilitate services being provided to new businesses in different geographies.

EMPLOYMENT LAW ISSUES

Employment laws differ significantly between countries, which will have a major impact on extending agreements to new territories. For example, a transition of employees in Europe will have to take into account the legislation regarding the protection of employees in the context of a transfer of undertakings (TUPE) and in some countries, such as Germany, will involve the relevant works council. In addition, the different structure of social security systems will require different solutions for transitioning employees, and the existing contractual provisions may simply be unsuitable.

Some amendments to the agreement may also be necessary, even where there is no plan to transition employees. For example, while background checks and drug screenings are prevalent in the United States and are often required of outsourcing providers, this is still uncommon and debatably not legal for most employees in Europe.

DATA PRIVACY AND STANDARDS ISSUES

If an existing US outsourcing contract is extended to European entities, additional provisions will also be required to comply with European data protection laws.

If personal data is to be transferred to the outsourcing provider in the United States, special consideration has to be given to the use of the new EU–US Privacy Shield, model clauses, or binding corporate rules.

Finally, while it is common for European entities to be certified under quality standards such as ISO 9000, and to require a similar certification from the outsourcing provider, US entities often need to ensure that they remain compliant with the Sarbanes–Oxley Act through various audits and other confirmations of internal controls.

DIVESTMENTS AND SPIN-OFFS

Divestments and spin-offs have unique requirements with respect to outsourcing contracts. In these transactions, the goal is not to merge and streamline the operations of the companies involved, but to make sure that both organisations continue to have access to their own, business-critical outsourcing services.

Where a single outsourcing agreement for the whole group exists, it may be questionable whether or not divested affiliates or spun-off business units can still obtain these outsourcing services post-closing. Even without an explicit change-of-control clause, an entity that no longer belongs to the group may simply be no longer within the scope of the agreement. It should therefore be determined whether or not the outsourcing agreements allow entities to continue obtaining services for a transitional period. In some cases, the affected entity will have to negotiate a new contract just to continue receiving the services and maintain operational continuity.

A divestment or separation raises the question of whether or not the part of the group that holds the outsourcing agreement can actually reduce or remove the scope of the agreement or the services it no longer needs. If the target no longer requires the outsourcing services, the contract needs to be checked to ensure that the outsourcing agreement contains provisions that enable a smooth, and not financially punitive, transition away from the old outsourcing provider.

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Recent Trends in Oil & Gas M&A in Europe and Africa

LISA O' NEILL, SHASHANK KRISHNA AND MARTA WROBEL

Historically, a decline in crude oil prices has been a key factor in increased M&A activity. Despite the price of crude oil having been steadily declining for two years, we're only now seeing an upturn in M&A.

Following almost a decade of relatively high crude oil prices, the price of crude oil started declining in 2014. A number of reputable industry analysts expect crude oil prices to be "lower for longer" in this downturn. Iran's increase in crude oil supply and the excess of refined product supply in the world markets, which forces refiners to pare-back their purchase of crude oil, are some of the key factors that are creating downward pressure on crude oil prices in 2016.

Oil & gas companies and the countries financially dependent on oil revenues have been feeling the squeeze.

Historically, a decline in crude oil prices has resulted in an increase in M&A activity. This is supported by McKinsey's analysis of the historical data (available at http://www.mckinsey.com/industries/oil-and-gas/our-insights/mergers-in-a-low-oil-price-environment-proceed-with-caution).

In 2015, however, M&A activity was hampered because there was a valuation gap between sellers' and buyers' expectations. The "new normal" of lower crude oil prices, coupled with pressure from lenders to sell assets (as the industry is highly indebted), and the limited scope left for cost cutting measures, is, however, now leading parties to reach a pricing equilibrium in 2016.

This shift towards pricing equilibrium is opening up M&A opportunities for oil & gas industry participants to

- Restructure their business, with many exiting from their non-core jurisdictions and from high-risk exploration activities
- Acquire or swap assets to either consolidate in their basins or regions, or enter into new jurisdictions, while prices are low
- Reduce their leverage to ensure compliance with their debt covenants or to stabilise their balance sheets
- Farm-down interests to ensure that capital is available to comply with minimum work commitments
- Obtain investments from relatively recent entrants to the oil & gas industry, such as financial institutions and private equity groups that have raised capital recently and may take a long-term view on crude oil prices.

THE NEW LANDSCAPE FOR OIL & GAS M&A

Financial Investors and Alternative Funding Sources

With their revenues decreasing and many projects modelled on higher crude oil prices, it is no surprise that many oil & gas companies are now struggling and therefore urgently seeking alternative funding sources. Many privately-held independents are searching for new investors or alternative forms of finance to help them meet upcoming minimum work commitments and to reduce the extent of their exposure to higher risk assets.

In recent years, private equity and other financial investors have shown greater flexibility in their approach and are applying new models. These have greater tolerance around the timeframe for achieving income and capital returns, enabling investment into oil & gas companies.

Producing and midstream assets are expected to attract further investments from financial institutions; as such assets typically provide stable returns. Financial investors typically look for companies with experienced management teams who require minimal support.

Opportunistic M&A

According to Wood Mackenzie (in a report available at http://www.woodmac.com/analysis/Upstream2016-Mergers-and-acquisitions-outlook), M&A in the upstream oil & gas sector should increase by the end of 2016, regardless of what happens to crude oil prices. In their view, if oil prices stay low, companies will be forced to sell assets and consolidate operations to free up capital, cut costs and survive amid growing financial pressures. If crude oil prices do recover by the end of 2016, oil & gas companies will look to catch the next up-cycle and re-focus from survival to growth.

As valuations become more realistic, it is expected that the counter-cyclical buyers who are willing and have the funds to take a long-term view on the crude oil prices will be looking for opportunities. This trend is expected to be reinforced as the lenders to the oil & gas companies revise the value of their borrowing base and force the borrowers to either raise fresh equity or sell assets.

Portfolio Diversification

To cope with the current industry environment, many oil & gas companies have focused on diversifying their portfolios to focus on lower risk assets. This is resulting in increased sales of assets in higher risk jurisdictions.

The current low crude oil prices also mean that some oil & gas companies have refocused their business on the acquisition of producing assets, with a view that supply and demand will come back into balance in due course, leading to an increase in the value of those assets.

Asset Swaps

Where cash is not readily available for acquisitions, companies have explored asset swaps, which allow them to develop an asset portfolio without having to spend cash. Asset swaps do, however, have some inherent transaction risks, such as the risk of the legal title not transferring simultaneously, specifically if the assets being transferred are located in different jurisdictions and where government approvals may be required.

While asset swaps are mostly structured as non-cash transactions, the parties are still required to value the asset being swapped for taxation purposes, which may also be challenging.

New Jurisdictions

With the discovery of the Jubilee oilfield off the coast of Ghana in 2007, and subsequent hydrocarbon finds in Kenya, Mozambique, Tanzania and Uganda, Africa has emerged as an exciting prospect for international oil & gas companies. The continent presents some inherent and unique risks, but it continues to be explored as a result of its large hydrocarbon potential.

THE OUTLOOK FOR 2016/2017

Oil & gas companies have been aggressively cutting costs. According to EY (available at http://www.reuters.com/article/oil-delays-idUSL5N0Z22WR20150616), projects worth approximately US$200 billion have already been cancelled or postponed since 2014. Oil & gas companies have also been renegotiating financing terms with their lenders, and their supply and service contracts, in addition to trying to divest non-core, high-risk assets. The conditions have, however, proved to be difficult.

While the macro-economic environment remains challenging, there is a view that the combination of the flexibility being shown by investors, the move towards a pricing equilibrium between buyers and sellers, the realisation by the oil & gas industry that crude oil prices will be "lower for longer", and the increasing number of distressed players in the market, will all result in an increase in M&A in the oil & gas sector through the end of 2016 and into 2017.

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The Impact of CIFUS Reviews on M&A Transactions

DAVID LEVINE, RAYMOND PARETZKY AND SHERRY LIU

CFIUS reviews mergers, acquisitions or takeovers that may pose a risk to US national security by foreign control of an entity engaged in US interstate commerce.

The Committee on Foreign Investment in the United States (CFIUS), which is comprised of members from the Departments of Treasury (chair), Homeland Security, State, Defense, Justice, Commerce and Energy, was established by executive order in 1975 to monitor foreign investment. Under current legislation (50 USC App. 2170), CFIUS reviews mergers, acquisitions or takeovers that may pose a risk to US national security by foreign control of an entity engaged in US interstate commerce.

Transactional parties should evaluate the benefits of voluntarily notifying CFIUS in advance of completing any "covered transactions." While doing so may generate additional costs and might delay closing, failing to obtain prior CFIUS approval may require a deal to be restructured or even unwound. In addition, with only a few exceptions, once a transaction passes CFIUS review it may not be reinvestigated.

Relative to an entire transaction's costs, the time and legal fees associated with voluntary review are a small and important investment. It is therefore no surprise that there has been a noticeable increase in the number of deals voluntarily submitted for CFIUS review – from 65 in 2009 to 147 in 2014, the last year covered by a CFIUS annual report to Congress.

THE CFIUS PROCESS

A CFIUS review may be initiated through a voluntary written notice jointly filed by the transactional parties or directly by CFIUS at any point during the transaction, even post-closing. The CFIUS review process has a strict timetable, beginning with a 30 day review followed, if necessary, by a 45 day investigation and 15 day US Presidential review.

CFIUS examines factors pertaining to US national defence; US technological leadership; US critical infrastructure, resources and technologies; control of the foreign acquirer by a foreign government; and adherence by the acquirer to US export control requirements. CFIUS considers these factors in light of the parties' government contracts, cyber security practices, supply chain features, and the proximity of business operations and property to US government facilities.

"Critical infrastructures and resources" include vital systems and assets, physical or virtual, the incapacity or destruction of which would have a debilitating impact on national physical or economic security, and/or public health or safety. "Critical technologies" may include either defence or other export-controlled technology. CFIUS may examine whether or not the US target has classified contracts with the US government, or technology that is subject to export controls or needed for national defence.

Parties filing a voluntary notice are well advised to allow for adequate pre-notice time and to prepare the notice at the same time as drafting transactional agreements and conducting due diligence. They should establish responsibilities among personnel and agree on the process for preparing the notice and for dealing with CFIUS. Parties should also agree whether or not to include deal terms contingent on the outcome of the CFIUS review.

It is important for parties to engage in a dialogue with CFIUS prior to filing the materials needed for the review, since the 30-day review clock starts ticking only after CFIUS staff determine that the joint notice is sufficient. Parties should initiate an informal discussion with CFIUS staff and work cooperatively with them to ensure the notice is complete and to address all of CFIUS' questions.

If, at the end of the 30-day review, all CFIUS members conclude that the transaction poses no threat to US national security, CFIUS notifies the parties that

it does not intend to take further action and the deal is cleared. Alternatively, CFIUS may begin a 45 day investigation, at the conclusion of which, if CFIUS finds that the transaction is not a national security threat, the transaction is cleared. If CFIUS concludes that the transaction does threaten national security, it may ask the parties to restructure the transaction to mitigate the threat or, in rare cases, may recommend to the President of the United States that the transaction be prohibited or suspended.

> "It is important for parties to engage in dialogue with CFIUS prior to filing the materials."

CFIUS TRENDS

The CFIUS process has been criticised for its complicated nature, amorphous definitions and lack of transparency. Regardless of the criticism, CFIUS-reviewed transactions have increased dramatically in recent years, from 65 CFIUS notices, 25 investigations and two notice withdrawals in 2009, to 147 CFIUS reviews, 51 investigations and nine notice withdrawals in 2014. It is unclear whether the increase in CFIUS reviews merely correlates with an increase in cross-border transactions (from 900 foreign acquisitions of US targets in 2009 to 6,000 in 2014), or whether it reflects a unique rise in CFIUS-based concerns, *i.e.*, US national security. Under either scenario, reported trends may help in deciding whether or not to seek review.

From 2012 to 2014, China accounted for the most CFIUS notices filed and reviewed (19 per cent), followed by the United Kingdom (13 per cent), Canada (11 per cent) and Japan (10 per cent). From 2009 to 2014, CFIUS notices primarily came from the following sectors: manufacturing (41 per cent); finance, information and services (FIS) (32 per cent); mining, utilities and construction (MUC) (19 per cent); and wholesale, retail and transportation (WRT) (8 per cent).

From 2012 to 2014, Chinese, UK and Japanese acquirers generally reflected these sector averages, while Canadian acquirers concentrated on the MUC and WRT sectors; French, German, Israeli and Swiss acquirers on the manufacturing sector; and Australian, German, Dutch and South Korean acquirers on the FIS sector. From 2009 to 2014, the number of CFIUS notices proceeding to investigations has consistently ranged from roughly 35 per cent to 40 per cent.

The following is a subsector breakdown of CIFUS activity in 2014:

- **Manufacturing**: The computer and electronic products (42 per cent), machinery (13 per cent), transport equipment (13 per cent) and chemical (10 per cent) subsectors yielded the most CFIUS notices.
- **FIS**: The professional, scientific, and technical (37 per cent), publishing (24 per cent) and real estate (11 per cent) subsectors produced the most CFIUS notices. Publishing industries experienced the greatest growth from 2013 to 2014 (18 per cent), with software publishing representing a significant number of covered transactions.
- **MUC**: The utilities (52 per cent), oil and gas extraction (20 per cent), and mining (12 per cent) subsectors yielded the most notices, with oil and gas extraction experiencing the most growth in the period 2012 to 2014 (5 per cent).
- **WRT**: Support activities for transportation (53 per cent) and merchant wholesalers for nondurable goods (20 per cent) generated the most CFIUS notices. Support activities for transportation and merchant wholesalers for nondurable goods experienced consistent growth from 2011 to 2014 (7 per cent and 9 per cent respectively), while merchant wholesalers for durable goods experienced a significant decrease (from 22 per cent to 0 per cent).

CFIUS treats all the material it reviews as confidential and does not publish transaction-specific information. The information released by transaction parties and news reports does, however, help illustrate some key factors considered by CFIUS that have resulted in deal terminations or mitigations.

These include consideration of whether or not an acquisition of a US fibre optic network posed a risk to the security of US data transmissions and increased the possibility of foreign wiretaps; an acquisition of an oil company could impact US energy supplies; a foreign acquirer was associated with its country's military; US property proposed for acquisition was located close to sensitive US military installations; and, recently, whether or not the acquisition of mobile data software applications posed risks of breaches of data privacy.

In light of the uncertainty and scheduling issues posed by the CFIUS process, parties to foreign acquisitions of US businesses should plan early to collaborate and to prepare for possible CFIUS review.

CFIUS annual reports may be accessed online at https://www.treasury.gov/resource-center/international/foreign-investment/Pages/cfius-reports.aspx.

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Coordinating the Effective Date of Mergers in a Global Post-Acquisition Integration

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Global companies that acquire other global companies must often navigate multiple, very different legal regimes to achieve their integration goals.

Negotiating a business combination with a large global competitor is a complicated process, and the complications do not necessarily end at the closing of the deal.

The primary focus of post-acquisition integration projects is to eliminate redundant legal and operational structures. Duplicated legal entities mean duplicate costs, including taxation, human resources and the basic operational and legal costs of maintaining the separate entities. Redundant legal entities can also lead to market confusion.

The other main area of concern is the coordination of the timing of the business combination to ensure the following being in place the day the merger comes into effect:

> The two companies ready, from an operational perspective, to start acting like a single company, *e.g.*, pitching for work and processing payroll.

> Supplier and customer contracts from the redundant entity transferred to the surviving acquirer entity.

> The licences and regulatory approvals needed to effect the transfer of the redundant entity's business to the surviving acquirer entity.

> The legal transfer of employees and employment insurance.

The company will also prefer to have the legal effective date of the merger coincide with the effective date of the merger from a tax and accounting perspective

THE GLOBAL PICTURE

In the United States, the primary means for eliminating a redundant target legal entity is to merge it out of existence. US merger law is very accommodating and flexible, which results in a clean transfer of the assets and liabilities of the redundant entity into the acquiror's legal structure. These mergers can often be structured as tax-free reorganisations under the US federal income tax law. Timing is also very manageable in the United States, as most states permit mergers to be effected within a single day.

Many global companies discover that, in other jurisdictions, however, it is not possible to achieve these objectives when combining redundant and surviving entities through mergers or similar transactions.

In many countries, including Austria, China, Finland, Germany, Sweden and Switzerland, the "legal" effective date of the merger is tied to the date the merger is officially "registered" in the local commercial registry, which relies to a large extent on the actions (or inactions) of certain commercial courts and regulators. In practice, in certain countries (including Austria, Finland, Germany, Sweden and Switzerland) the company's "preferred" legal effective date may be requested, and is ordinarily respected by the commercial registry.

In Italy, provided that the merger is by acquisition (a company merging with and into another existing company, with all assets and liabilities transferring to the surviving company), the effective date can be postponed until the date on which the deed of merger has been filed with the competent local commercial registry. The Italian Civil Code provides simplified rules for mergers of a company that is fully owned by the absorbing entity, which can help to eliminate redundant entities.

In China, however, the legal effective date of the merger is the date determined by the local commercial registry, *e.g.*, Shanghai or Beijing, which has complete discretion. For this reason, many business combinations in China that start as legal "mergers" often end as a transfer of assets and liabilities, given the greater flexibility in determining the effective timing.

Not all jurisdictions provide for statutory mergers. For example, in the United Kingdom, the process of combining the operations of a redundant legal entity after a business combination is more often accomplished through a transfer of assets and liabilities, followed by the liquidation of the redundant entity. Although France does provide for a statutory merger, many companies often choose to follow the *transmission universelle de patrimoine* (TUP) process, instead of a merger. The TUP process allows for a relatively expedited and straightforward transfer of assets and liabilities and the liquidation of the redundant entity.

COORDINATING LEGAL EFFECTIVENESS WITH ACCOUNTING EFFECTIVENESS

Some jurisdictions do differentiate between "legal" and "accounting" effectiveness, raising some planning issues that companies should discuss with their auditors.

Certain countries, such as Germany and Spain, require the merging companies to submit financial statements alongside a request for merger approval. In Germany, the "accounting effective date" of the merger will be the closing date of the balance sheet of the redundant entity filed with the commercial register, which will precede the legal effective date. In Spain, the "accounting effective date" will be the first day of the fiscal year in which the merger was approved.

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