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CMS European M&A Study 2015

Seventh Edition

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The results of the Study and/or this report and the conclusions presented in the Study and/or this report do not necessarily reflect the views of any member of CMS, the lawyers or the support staff who assisted with preparation of the Study and/or this report. The Study and/or this report evaluated over 2,400 M&A transactions. Inevitably, there were many differences between the underlying agreements, and the vast majority of them were negotiated. In order to compare the results, individual provisions were categorised. When categorising the individual provisions, a degree of subjective judgment was necessary. Although certain trends can be deduced from the Study and/or this report, each transaction has individual features which are not recorded in the Study and/or this report and to which no reference is made. As a result, the conclusions presented in the Study and/or in this report may be subject to important qualifications that are not expressly articulated in the Study and/or in this report.

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Introduction

We are delighted to present the CMS European M&A Study (the “Study”). This is our seventh annual study which means that we have now reviewed over 2,400 deals for the eight-year period of 2007–2014, a period of prosperity, financial crisis, significant geopolitical changes, concerns about the stability of the Eurozone and possible exits, followed by signs of a sustainable recovery in Europe.

The CMS European M&A Study 2015 provides insight into the legal provisions of mergers & acquisitions (M&A) agreements, makes comparisons across Europe and with the US and identifies market trends. It evaluates private M&A agreements relating to both non-listed public and private companies in Europe for the eight-year period 2007–2014. Of the 2,414 transactions we analyse in the Study, 346 relate to 2014.

Particular highlights in our Study are the CMS Trend Index, Sector Focus and, for the first time, an impact analysis of deals covered by W&I insurance:

- **CMS Trend Index** – we provide a CMS Trend Index to illustrate a current fact or trend for the particular feature reported on.
- **Sector Focus** – CMS has adopted for a number of years a sectoral approach and accordingly we present risk allocation statistics within specific sectors. We provide 2014 sector statistics for a number of areas we report on, namely locked box deals, earn-outs, liability caps, limitation periods and MAC clauses.
- **W&I Insurance** – we look at the role of W&I insurance and how it affects typical risk allocation features of M&A deals.

The data used in the Study is not publicly available and is based on privately negotiated transactions in which CMS acted as an advisor to either the buyer or the seller. CMS is one of the few legal service providers with the capability to provide a European study of this kind due to its presence and market penetration in a wide range of jurisdictions across Europe.

We do hope that this Study helps you in your day-to-day M&A life. We are of course very interested in any suggestions, and would be more than happy to discuss and share any experiences you may have.



Stefan Brunnschweiler
Global Head of CMS Corporate/M&A Group

CMS European M&A Study 2015

"2014 is likely to be much more active than 2013 with all the indicators pointing in that direction" (CMS European M&A Study 2014). It was. The statistics reveal the most active M&A market since the financial crisis. Global M&A was up 45% in value. European M&A was up 41% in value (and 5% in volume). So, more deals and certainly larger deals than in 2013. Europe accounted for 28% of the world's M&A, a shade down on 2013, but still a very high proportion given the competition of fast developing economies and regions, ripe for M&A.

There was a boom in cross-border M&A with 36% of deals being inbound European deals – that's about 1,200 deals with a value of USD 320bn – the highest inbound figure in both volume and value since 2001. Outbound European M&A activity surged by 190% compared with 2013.

So, what was the reason for this surge of activity? One factor is obvious – there was a lot of action in the EU/North American corridor. 61% of that inbound European activity came from the US, the highest ever proportion (by nearly 10%). In turn, the huge annual increase (190%) in outbound European activity was mainly directed towards North America.

This trend characterises a shift towards developed economies such as Europe rather than emerging markets. With 2014 being a quiet year in European politics and showing signs of a more stable Eurozone, the growing stability of Europe (apart from on its Eastern flank, Ukraine), provided a better risk/reward profile for investors than the developing economies. An ever strengthening USD also pointed North American corporations overseas, often towards Europe.

The second half of 2014 was laced with optimism with the European M&A Outlook, published in October 2014 by CMS and Mergermarket, concluding that: "Businesses are bullish about the level of M&A over the next 12 months with 67% of respondents considering either acquisitions or divestments or both."

Yet, the turn of the year sees new developments which may act as a brake on that optimism: threats to the Eurozone with the distinct prospect of a "Grexit"; a UK general election with a 2017 EU exit referendum being seen as a vote catcher for the present government; the dramatically reduced oil price; the growing "cold war" type posturing arising from Russia's actions in Ukraine; and, then again, the disturbing impact of terrorism atrocities.

Executive Summary

With a more active M&A market, it is no surprise to report that sellers are taking less risk in private M&A sale and purchase agreements. It has been moving in that direction since 2011 as the market has been recovering from the financial crisis, but now we see definite signs which are pro-seller. For instance:

- Liability caps are lower;
- Limitation periods are shorter;
- There are more baskets and *de minimis* provisions in all the European regions (although financial protection in terms of percentage of deal size seems to be getting lower);
- W&I insurance is becoming ever more popular and is a classic seller friendly mechanism providing low liability caps and getting the buyer to take protection for M&A risk through an insurance policy;
- MAC clauses remain relatively rare in Europe thereby ensuring seller deal certainty;
- Locked box mechanisms are becoming more popular and are being used throughout Europe;
- Security for warranty claims in favour of buyers is less frequent over the last two years;
- Non-compete covenants are fewer.

There has been a change in behaviour relating to earn-outs during 2014, particularly in Northern Europe. There are more earn-out deals and a greater conformity about the length of earn-out periods and the basis of earn-outs.

As ever there are regional differences. France still has the lowest liability caps but long warranty periods. CEE sees the most MAC clauses and arbitration is the likely dispute resolution mechanism. The UK remains wedded to *de minimis* and basket provisions although interestingly seller's liability caps in the UK seem to be higher than in other regions. Deals in German-speaking countries seem to occupy the middle ground on most issues as far as risk allocation in Europe is concerned. We continue to see similar trends in all or most of the European regions rather than on an individual basis.

Key conclusions

The key conclusions of the CMS European M&A Study 2015 are as follows:

- **Purchase price adjustments** – the number of deals containing purchase price adjustment mechanism slightly increased in 2014 although the general trend has been generally downward for several years prior to that.
- **Locked box** – there was a significant increase in the number of locked box deals in 2014. In particular, there were significant increases in the use of locked box in Southern Europe and France, where in both regions usage increased by almost 200% compared with 2013, where applicable.
- **Earn-outs** – there was a sea change in 2014. Earn-outs which had generally been running at a rate of 14% of total deals in previous years increased significantly to 19% of 2014 deals, particularly in Northern Europe where its usage was comparable with that in the US (21% compared to 25%).
- **Earn-out period** – there were also significant changes in the duration of earn-out periods with the greatest concentration of earn-outs being for the 12–36 months period. This was the case in 57% of 2014 earn-out deals compared with 48% in 2013.
- **Earn-out basis** – although EBITDA based earn-outs continue to be the most popular, there were more turnover based earn-outs in 2014 than in 2013 (31% compared with 21%) whilst earnings (as opposed to EBITDA) based earn-outs dwindled to a mere 6%.
- **De minimis** – the trend for the greater use of *de minimis* provisions continues. They were generally used as a matter of course in virtually all regions during 2014.
- **Baskets** – again there was a greater use of baskets, in 69% of cases, whilst 'first dollar' recovery is now clearly the standard basis of recovery, perhaps even in France. By comparison the US continues to favour the 'excess only' recovery basis.

European and US differences

- **Liability caps** – sellers were more successful in limiting their liability to less than half the purchase price in 2014 with 53% being successful as opposed to only 47% in 2013. Furthermore, the actual usage of liability caps for less than the purchase price was much more frequent in 2014 with 65% of sellers limiting their liability to less than the full purchase price in 2014 as opposed to only 53% of sellers being able to do that in 2013.
- **Warranty & Indemnity insurance** – the Study clearly demonstrates the difference between W&I deals and non-W&I deals in our section on W&I. Most eye-catching is the average liability cap of sellers in W&I deals at a mere 5%. In fact, in 81% of W&I deals, the seller's liability cap is less than 10% of the purchase price compared with a mere 9% for non-W&I deals.
- **Limitation periods** – we see a greater concentration in the 'mid-periods' in 2014 deals, namely 12–18 months and 18–24 months which apply in 69% of deals (as opposed to only 60% in 2013). Deals with a 'long tail' dipped in 2014 with only 15% showing limitation periods exceeding 24 months.
- **Security for warranty claims** – there was a notable decrease in the number of buyers looking to obtain some form of security (whether it be use of an escrow account, purchase price retention or bank guarantee). Such devices were used in only 29% of deals compared to 39% being the average for the previous seven years. Use of an escrow account was particularly prominent – being used in 67% of applicable cases, a far higher proportion than in previous years.
- **MAC clauses** – the proportion of deals with a MAC clause remained unchanged at 14% in 2014 compared with 2013 and therefore MAC clauses remain relatively rare in Europe in contrast to the US where a large majority of deals (94%) have MAC clauses.
- **Non-compete covenants** – 47% of deals had non-compete clauses, down from 49% in 2013.
- **Arbitration** – the number of M&A deals with an arbitration clause decreased slightly to 36%.

The Study continues to reveal significant cultural and regulatory differences within Europe when compared with the US:

- Earn-out deals are more popular in the US but for the first time, there is much more convergence between Europe and the US. 25% of US deals have an earn-out component, but in 2014, 19% of European deals, up from 14% in 2013, had an earn-out component. Back in 2010, the differential was much greater with 38% of US deals having an earn-out component compared with just 15% in Europe.
- MAC clauses are much more popular in the US than in Europe. MAC clauses were used in 94% of the deals in the US compared with just 14% of deals in Europe.
- Not only are baskets much more prevalent in the US, but the basis of recovery is different. In the US, 61% of relevant deals are based on 'excess only' recovery as opposed to 'first dollar' recovery compared with only 20% in Europe in 2014 for 'excess only' recovery.
- Purchase price adjustments continue to be used in the majority of US deals (85%) while only being used in 45% of European deals in 2014.
- Lower liability caps in US deals are more popular, with 93% of US deals having liability caps of 25% of the purchase price or less, compared with only 39% of European deals.
- Working capital adjustments continue to be by far the most frequently used criteria on a purchase price adjustment in the US, used in 91% of deals as opposed to just 41% in Europe in 2014, where the deal contained a purchase price adjustment.
- Basket thresholds tend to be lower in the US with 88% being less than 1% of the purchase price compared with 52% in Europe.

Differences within Europe

The Study also revealed significant differences in customs and practices within Europe, including:

In Benelux:

- Deals were the most likely to have escrow accounts as a mechanism for securing warranty claims (31%).
- Deals have the shortest general warranty periods with none exceeding 24 months.

In Central and Eastern Europe (CEE):

- Deals were the most likely in Europe to have a MAC clause (38%).
- Arbitration continues to be the main dispute resolution process (74% compared with the European norm of 37%).

In German-speaking countries:

- Deals were the least likely to have a short warranty limitation period of up to 12 months (14%).
- Earn-outs continue to be popular with 22% of deals containing earn-out provisions.

In France:

- 24% of French deals had earn-outs.
- In 54% of transactions with a basket, the basis of recovery was 'first dollar' – this is the first time that the majority of French deals have had a 'first dollar' recovery basis.

In Southern Europe:

- 82% of deals used a locked box mechanism where there was no purchase price adjustment.
- Deals were the least likely to have a *de minimis* provision (46%).

In the UK:

- Deals were the least likely to have a MAC clause (only 3%).
- The higher liability caps within Europe can be found with 61% of UK deals showing a liability cap of at least 50% of the purchase price and only 27% of UK deals showing a liability cap of less than 25% of the purchase price, in both cases the highest proportion and lowest proportion of those metrics within Europe.

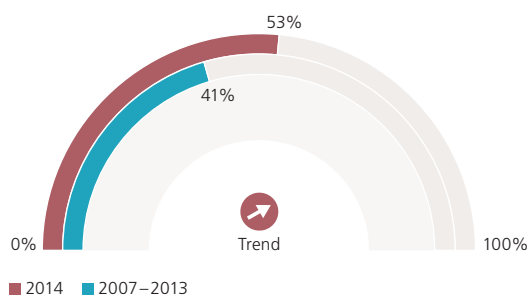
CMS commentary

- CMS transacted 346 deals in 2014, reflecting a year-on-year increase since 2009.
- We expect a stable M&A market in 2015 without the dramatic rises seen in 2014.
- There are inevitably differences year on year between different categories of risk allocation points covered by the Study. These points continue to be heavily negotiated in M&A deals, but overall risk allocation as between sellers and buyers has remained fairly constant since 2011.
- We expect the most active sectors in volume to be TMC and Consumer Products and for value to be led by TMC with Lifesciences, Energy and Consumer Products vying for second place.

Purchase price adjustment

CMS Trend Index

Locked box



Locked box deals increasing

In 2014, the number of deals containing a purchase price adjustment mechanism increased marginally to 45% from 43% in 2013. The overall trend over the period 2007–2014 is for fewer transactions containing purchase price adjustment mechanisms.

CMS Sector Analysis

Locked box

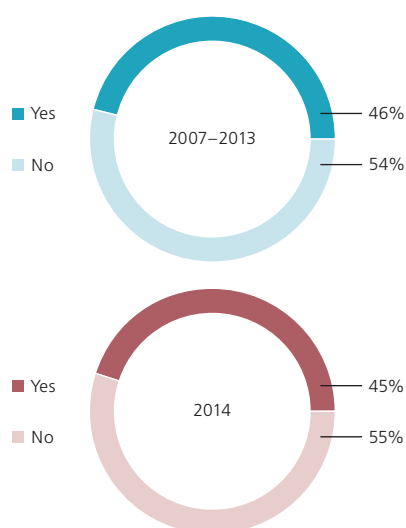
Sector	2009–2013	2014
Banking & Finance	34%	50%
Hotels & Leisure	36%	36%
Energy	35%	55%
Consumer Products	47%	69%
Technology, Media & Communications	48%	47%
Infrastructure & Projects	20%	33%
Lifesciences	54%	52%
Real Estate & Construction	22%	30%
Industry *	60%	61%
Business (other services) *	43%	69%
CMS average	43%	53%

100% = transactions with no purchase price adjustment mechanism
(deals with purchase price adjustment and locked box are not included)
* no inquiry in 2009

Locked box most used in Consumer Products and Business deals

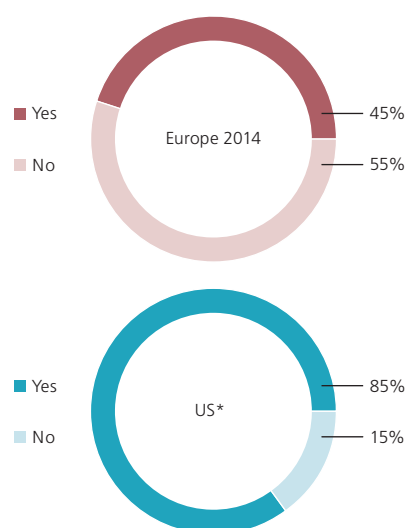
With regard to the US, purchase price adjustment clauses are still more popular than in Europe with 85% of US deals including purchase price adjustment clauses compared with 45% in Europe.

Purchase price adjustment 2007–2014



100% = all evaluated transactions

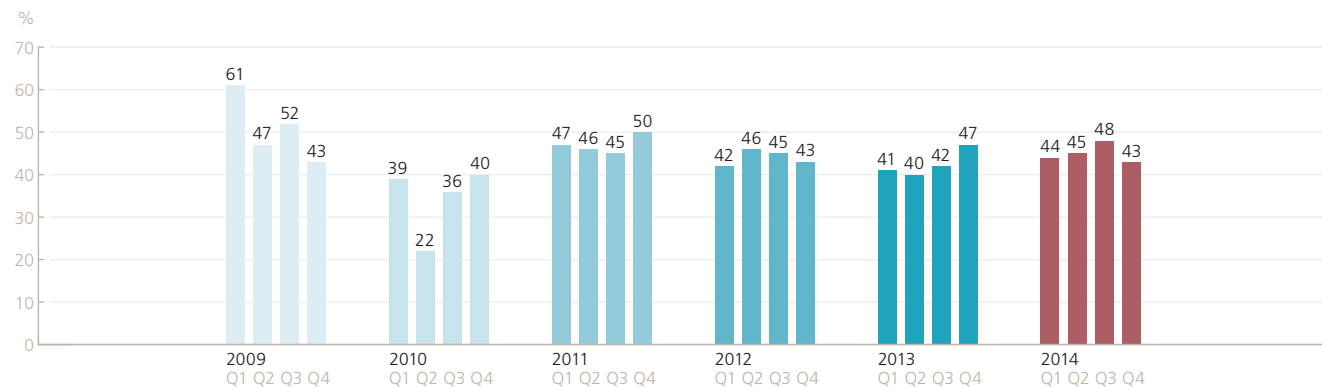
Purchase price adjustment Europe/US



100% = all evaluated transactions
* US data derived from "2013 Private Target Mergers & Acquisitions Deal Points Study" by the American Bar Association (ABA), Business Law Section

Purchase price adjustment 2009–2014

Time trend: Steady number of transactions with purchase price adjustment



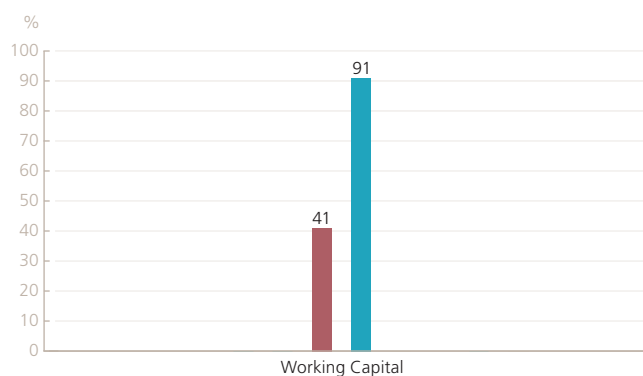
100% = all evaluated transactions

The upward trend in the second half of 2013 of deals containing a purchase price adjustment mechanism continued into 2014. For the first time for many years, there was overall a slight increase in the number of deals (45%) with purchase price adjustments in 2014. This arrests the steady downward trend in recent years.

In 2014, a working capital adjustment continued to be the most popular form of purchase price adjustment featuring in 41% of deals with a purchase price adjustment, a slight increase from 40% in 2013. However, the working capital adjustment is far more popular in the US where it is used in 91% of deals with a purchase price adjustment.

Purchase price adjustment Europe/US

Working Capital as adjustment criteria

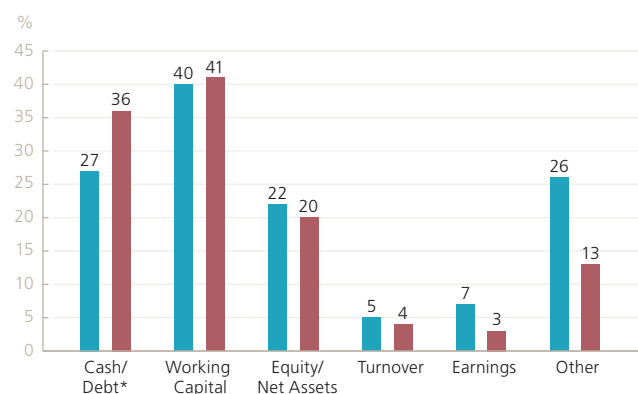


■ Europe 2014 ■ US 2012

100% = all transactions including a purchase price adjustment
 * US data derived from "2013 Private Target Mergers & Acquisitions Deal Points Study" by the American Bar Association (ABA), Business Law Section

Purchase price adjustment

Chosen criteria 2013/2014

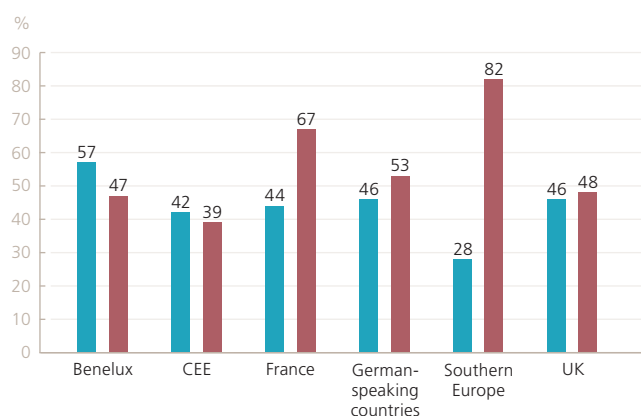


■ 2013 ■ 2014

100% = all transactions including a purchase price adjustment – multiple nominations possible
 * Cash/Debt does not include "cash only" and "debt only"

Purchase price adjustment (continued)

Locked box 2013/2014



■ 2013 ■ 2014

100% = transactions with no purchase price adjustment mechanism
(deals with purchase price adjustment and locked box are not included)



Locked box deals are increasing in most regions.

Locked box mechanisms look to fix the price without reference to any completion accounts adjustment. Much favoured by financial sellers, they depend on thorough financial due diligence by the buyer and a stable working capital position. Buyers are mainly concerned to ensure that cash is not extracted from the target company by the sellers.

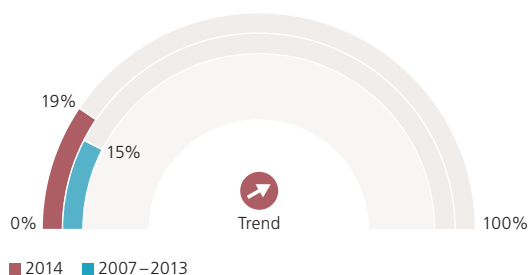
In 2014, the number of transactions without a purchase price adjustment which had a locked box element increased significantly to 53%. There are some noticeable regional differences underlying this result.

In particular, France had a significant increase in locked box deals (67% in 2014 compared with 44% in 2013 and just 18% in 2012) whilst the mechanism seems to have suddenly been adopted in Southern Europe with 82% of deals using a locked box mechanism doubling its popularity in that region compared with the previous five years and even tripling its usage compared with 2013 (28%). There were also notable increases in the number of locked box deals in German-speaking countries and in the UK during 2014. Locked box usage in 2014 was more commonly used in all regions compared with the period 2009–2013.

Earn-out

CMS Trend Index

Earn-out



Earn-out deals increasing

An earn-out is a mechanism in which part of the purchase price is dependent on the future performance of the target business. Both the benefits and the risk of the target company post-acquisition are therefore shared by seller and buyer. For the seller, earn-outs provide a chance to increase the purchase price. For the buyer there are also benefits, because the seller (usually individual managers) will be motivated to maximise business performance during the earn-out period.

For the first time in a number of years, earn-outs became more popular with 19% of deals having an earn-out component.

CMS Sector Analysis

Earn-out

Sector	2007-2013	2014
Banking & Finance	14%	19%
Hotels & Leisure *	11%	0%
Energy	15%	16%
Consumer Products	13%	17%
Technology, Media & Communications	18%	9%
Infrastructure & Projects *	3%	31%
Lifesciences	22%	35%
Real Estate & Construction *	18%	12%
Industry **	12%	21%
Business (other services) **	18%	28%
CMS average	15%	19%

100% = all evaluated transactions of the respective branch

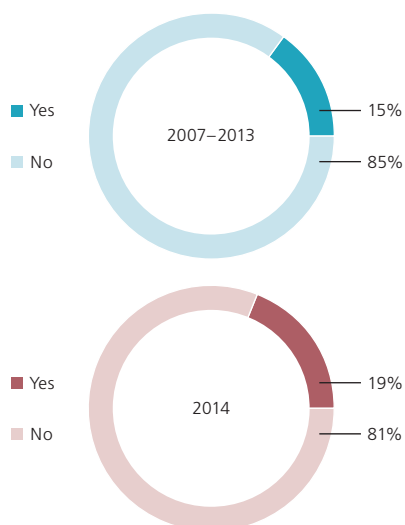
* no inquiry in 2007, 2008 ** no inquiry in 2009

Most popular in Lifesciences deals

This is the highest proportion of deals with earn-outs in the seven editions of the Study and represents a notable increase compared with the 15% average for the previous seven years.

In 2014, there was a significant increase of 200% in the number of earn-out deals in France (up to 24% compared with 8% in 2013) and in the UK (up to 19% compared with 6% in 2013) whilst earn-out deals were also popular in Benelux (23%) and again in the German-speaking countries (22%). Only in CEE and Southern Europe were there single digit percentages of earn-out deals. From this, we can see that the proportion of earn-out deals in Northern Europe is for the first time ever comparable to that in the US (25%).

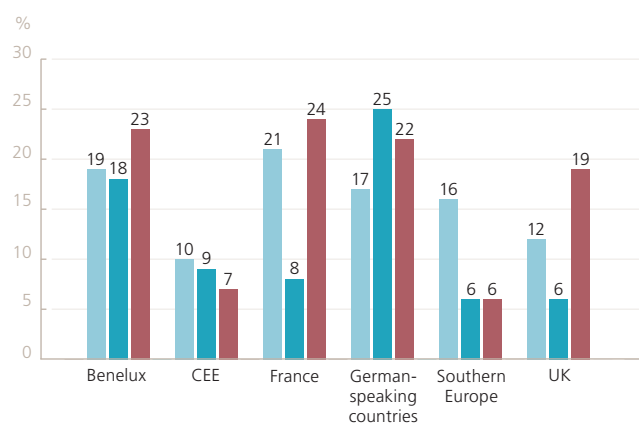
Earn-out 2007-2014



100% = all evaluated transactions

Earn-out 2007-2014

Time trend Europe

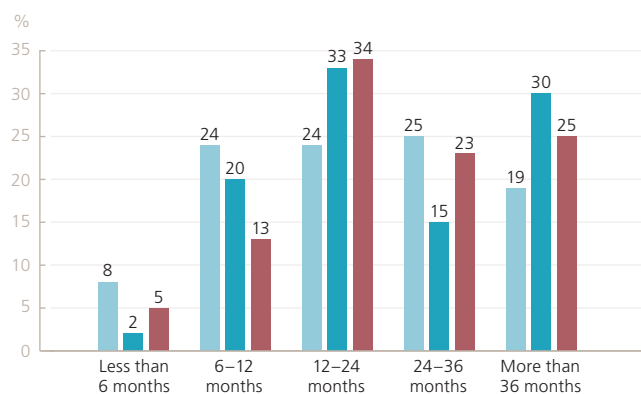


100% = all evaluated transactions

Earn-out (continued)

Earn-out 2012–2014

Duration of time periods relevant for the assessment of the earn-out



■ 2012 ■ 2013 ■ 2014

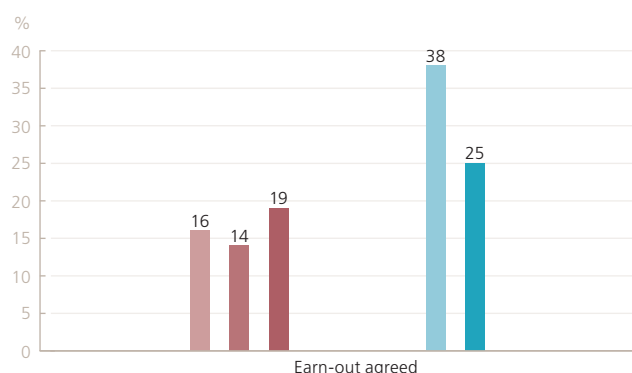
100% = all transactions including an earn-out clause

The length of earn-outs has become more concentrated in the 12–36 month period (57% of earn-out deals) rather than shorter or longer periods. The most popular earn-out period remains the 12–24 month period with a slight increase (34% compared with 33% in 2013), but there has been a reduction in long earn-out periods of more than 36 months (only 25% compared with 30% in 2013) and the shorter period of less than 12 months (only 18% compared with 22% in 2013).

There has been a notable convergence over the last few years between Europe and the US in relation to earn-out deals. With an average 19% of deals in Europe having an earn-out component (and some 21% in the Northern European countries) during 2014, this is comparable to the 25% of deals revealed in the most recent US data. Yet back in 2010, those same statistics were very different with just 15% of European deals having an earn-out component compared with 38% of US deals.

Earn-out Europe/US

Frequency of earn-out provisions Europe/US



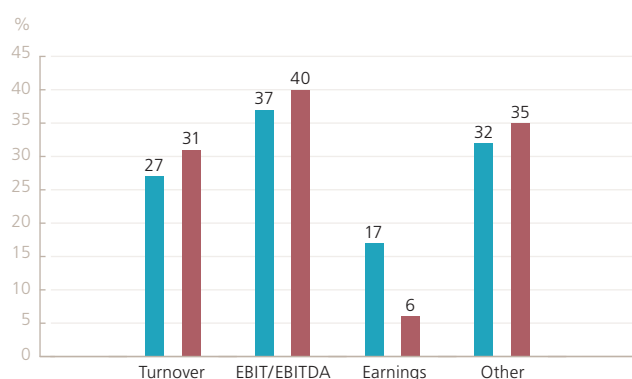
■ Europe 2012 ■ Europe 2013 ■ Europe 2014 ■ US 2010 ■ US 2012

100% = all evaluated transactions

EBIT/EBITDA based earn-outs have been increasing in popularity for some years and are now used in 40% of deals, although that was a slight fall against 43% in 2013. Turnover based earn-outs certainly gained popularity in 2014 with 31% of earn-outs being based on turnover (compared with 27% in the seven-year period 2007–2013 and a mere 21% in 2013). Pure earnings based earn-out formulae have been diminishing in recent years with just 6% in 2014.

Earn-out 2007–2014

Comparison of criteria used for earn-out

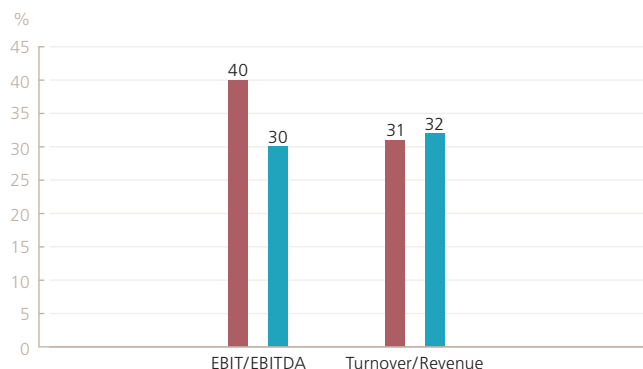


■ 2007–2013 ■ 2014

100% = all evaluated transactions – multiple nominations possible

Earn-out Europe/US

Earn-out criteria Europe/US

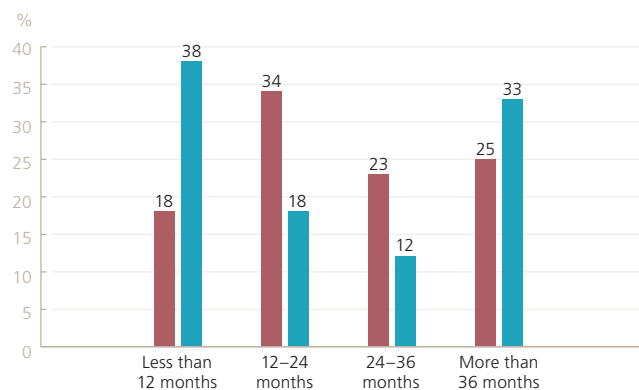


■ Europe 2014 ■ US 2012

100% = all evaluated transactions with an earn-out mechanism

Earn-out Europe/US

Duration of time periods relevant for the assessment of the earn-out



■ Europe 2014 ■ US 2012

The relevant criteria for calculating the earn-out amount are usually the subject of heavy negotiation. Earn-out deals are most commonly based on EBIT/EBITDA or turnover. In the US, however, turnover-based earn-outs have historically been more common than in Europe, but there has been a significant increase in turnover based earn-outs in 2014 so that they are now almost as common as in the US (32% in US compared with 31% in Europe). EBIT/EBITDA based earn-outs (30% in US compared with 40% in Europe) continue to be more common in Europe than in the US.

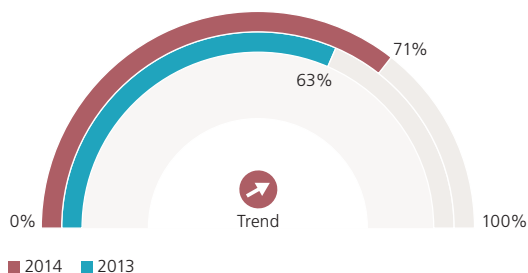
There is however a dramatic difference in the US experience as far as timing of earn-outs is concerned. This reveals that 38% of US earn-out deals are based on time periods of 12 months or less whilst another 33% are based on time periods of 36 months or more, leaving just 30% in the 12-36 month period, which is comfortably the most popular time period for European deals (57%).

“ Earn-outs now almost as popular in Europe as in US.

De minimis

CMS Trend Index

De minimis



Increase in deals containing de-minimis provisions

A *de minimis* provision means that an individual claim will only be considered if it is in excess of a minimum value. In general, a *de minimis* provision is seller-friendly.

In 2014, 71% of deals had *de minimis* provisions, compared with only 63% in 2013 and 51% back in 2010. At one stage, it seemed that there was a possible shift towards a US style approach where only a minority of deals had *de minimis* provisions, but now it seems more likely that European practice will prevail.

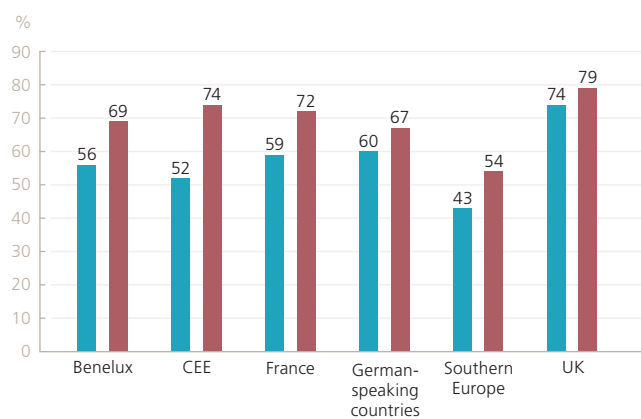
There are regional differences: for instance, *de minimis* provisions continue to be used regularly in UK deals (79%),

whilst Southern European deals are least likely to have *de minimis* provisions (54%). What is notable, however, is that in virtually every region there has been a steady increase in the use of *de minimis* provisions compared within the overall seven-year period preceding it with the effect that in every other region, apart from Southern Europe, two thirds of deals now have *de minimis* provisions.

Where there is a *de minimis* provision, up to 0.1% of the purchase price continues to be the most popular band (29%). *De minimis* provisions, however, seem to be getting progressively lower.

De minimis clause 2007–2014

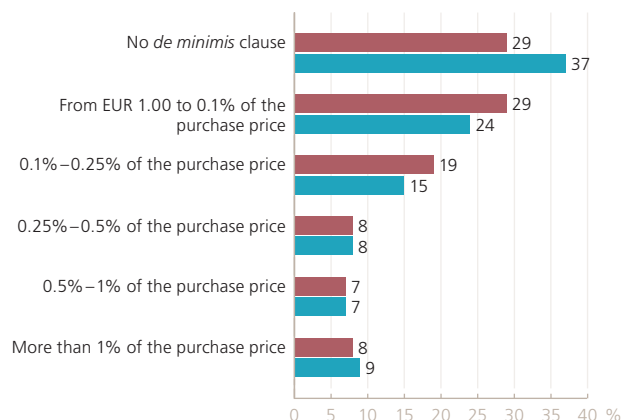
Time trend Europe: Transactions containing a *de minimis* clause



■ 2007–2013 ■ 2014

100% = all evaluated transactions

De minimis 2013/2014



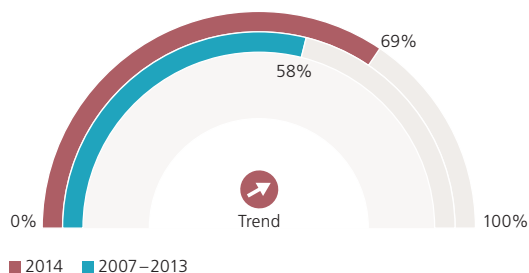
■ 2013 ■ 2014

100% = all evaluated transactions

Basket

CMS Trend Index

Basket



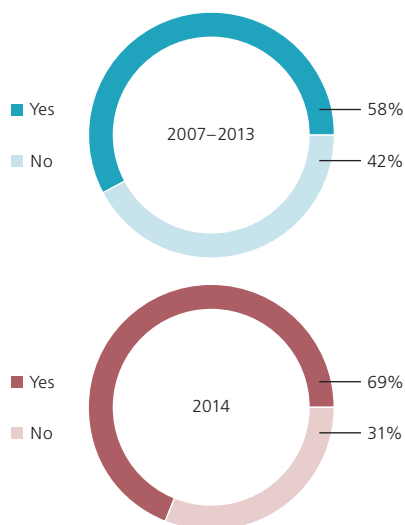
More deals containing baskets

A second seller-friendly threshold is the basket. The buyer will only be able to make a claim when the aggregate of all individual claims exceeding the *de minimis* threshold also exceeds the basket threshold.

There is a steady trend in the increase of baskets throughout Europe over the last few years. In 2014, 69% of the deals included basket provisions compared with 58% in the previous seven-year period 2007–2013.

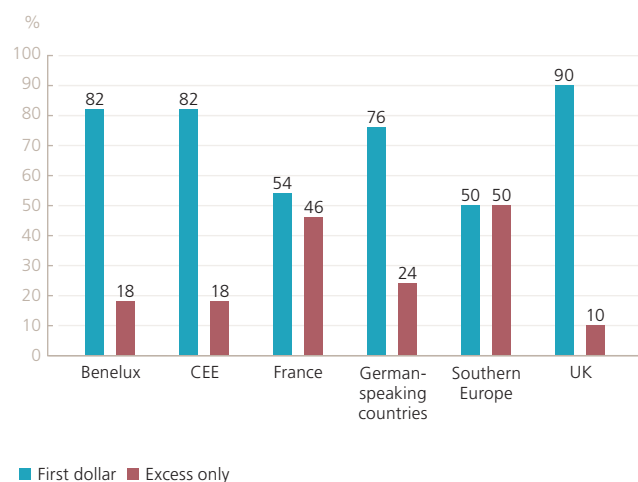
The increase is notable within Europe over this period – and only in Southern Europe it is less common than not to have a basket. If the basket threshold is exceeded, the buyer may either be entitled to make the entire claim (i.e. ‘first dollar’), or just the excess of the claim over the basket (i.e. ‘excess only’). As in previous years, ‘first dollar’ recovery is most common in UK, Benelux and CEE. In 2014, however, the ‘first dollar’ recovery was notably more popular in German-speaking countries (76% compared with 64% in 2013) and France (54% compared with 33%). In France, the majority of deals had ‘first dollar’ recovery as opposed to ‘excess only’ recovery for the first time.

Basket 2007–2014



100% = all evaluated transactions

Basket 2014

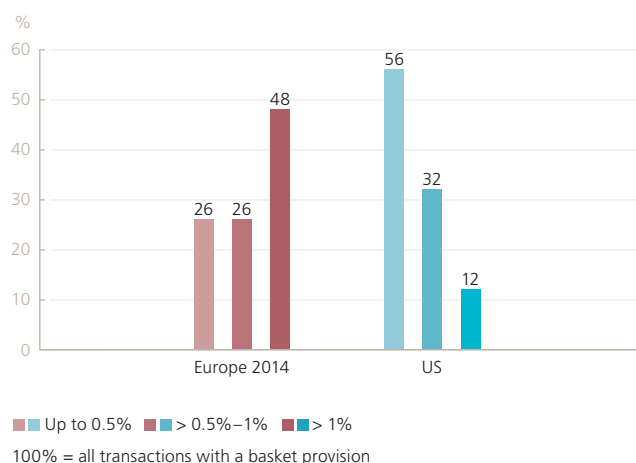


■ First dollar ■ Excess only

100% = all transactions with a basket provision

Basket (continued)

Basket thresholds Europe/US



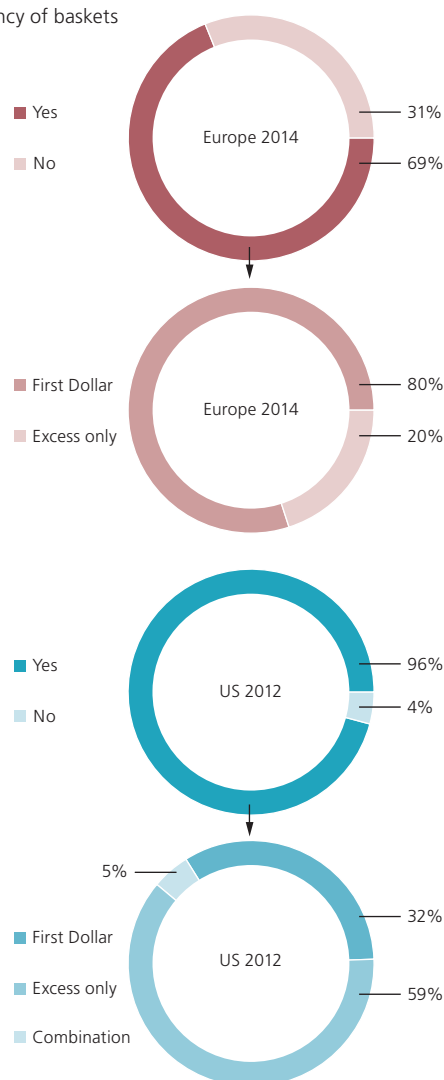
Therefore, the current trends are: more baskets in Europe; more baskets with 'first dollar' recovery; and slightly lower thresholds.

However, it continues to be much more the norm for US deals to have a basket provision (96%). Even though there is a much greater tendency for US deals to include a basket provision, it remains the case that: (i) the majority of European deals contain 'first dollar' baskets compared with US deals which have more 'excess only' baskets – in 2014, 80% of European deals had 'first dollar' baskets compared with 32% of US deals; and (ii) the threshold for the basket is generally lower in the US than in Europe with 88% of baskets having a threshold of less than 1% of the purchase price compared with 52% having a threshold of less than 1% of the purchase price in Europe. This 52% compares with 51% in 2013 and 49% in 2012.

The preeminence of 'first dollar' recovery is amply demonstrated by the following graphic showing falling popularity of 'excess only' recovery.

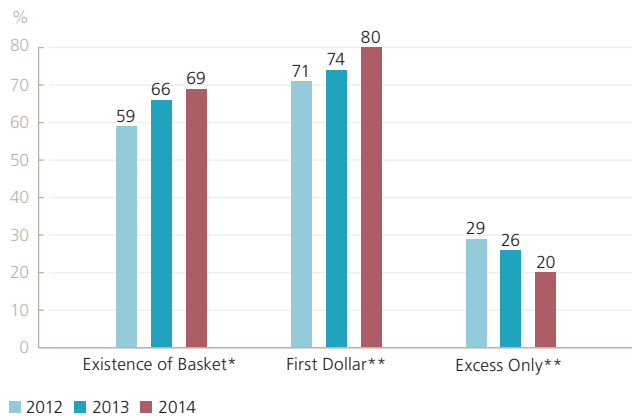
Basket Europe/US

Frequency of baskets



100% = all evaluated transactions

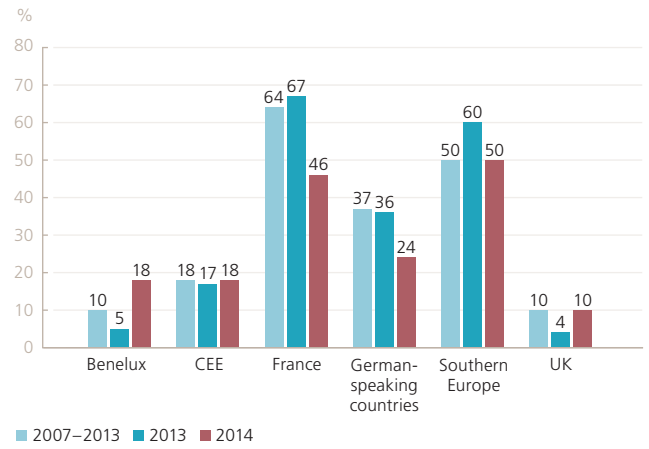
Basket 2012–2014



* 100% = all evaluated transactions

** 100% = all transactions with a basket clause

Basket/Excess only 2007–2014



100% = all evaluated transactions with a basket provision

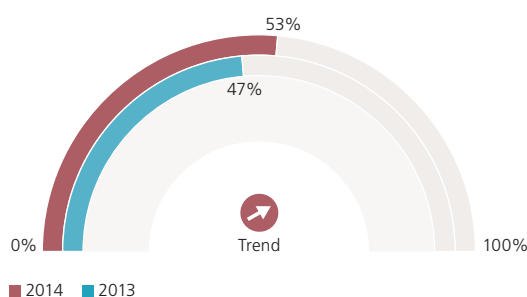


More baskets with slightly lower thresholds is the trend in Europe for 2014.

Liability caps

CMS Trend Index

Liability caps (less than 50% of purchase price)



Proportion of liability caps less than 50% higher in 2014

The concept of limiting the seller's aggregate liability under the sale agreement is standard. This is based on a common view that it would be unfair for sellers to assume a liability when selling their business which could be higher than the purchase price received for such sale. The issue for negotiation, therefore, is not so much the principle, but more the exact level of the liability cap.

There are still a significant number of deals with no caps with 14% of such deals in 2014. At first glance, it seems surprising that there are any 'no cap' deals, but there can be reasons e.g. if the only warranties given were title warranties, buyers are often not prepared to accept any cap.

In 2014, sellers were able to reduce liability caps, continuing the long-term trend which stagnated for one year in 2013. While sellers were able to limit their liability to less than half the purchase price in 2012 (in 54% of the deals), the number of such deals fell in 2013 to 47%. Sellers were almost back to 2012 levels in 2014, with 53% of the deals showing a liability cap of less than 50% of the purchase price. It is notable that the number of deals with a liability cap equal to the purchase price decreased from 29% in 2013 to 21% in 2014.

CMS Sector Analysis

Liability caps (less than 25% of purchase price)

Sector	2007–2013	2014
Banking & Finance	23%	25%
Hotels & Leisure *	35%	36%
Energy	24%	27%
Consumer Products	26%	38%
Technology, Media & Communications	29%	45%
Infrastructure & Projects *	14%	31%
Lifesciences	36%	33%
Real Estate & Construction *	33%	57%
Industry **	44%	33%
Business (other services) **	34%	27%
CMS average	32%	34%

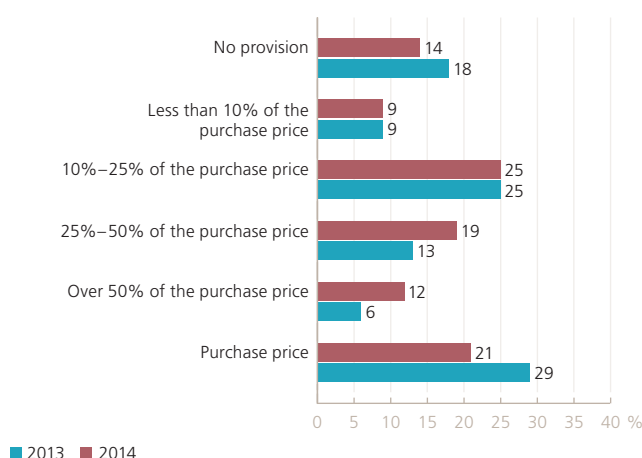
100% = all evaluated transactions of the respective branch

* no inquiry in 2007, 2008 ** no inquiry in 2009

Lowest liability caps in Real Estate & Construction, Technology, Media & Communications and Consumer Products

At the same time, the number of deals with a liability cap of 25–50% of the purchase price increased from 13% to 19%. It is also notable that the actual usage of liability caps for less than the purchase price was much more frequent in 2014 with 65% of sellers limiting their liability to less than the full purchase price in 2014 as opposed to 53% of sellers being able to do that in 2013.

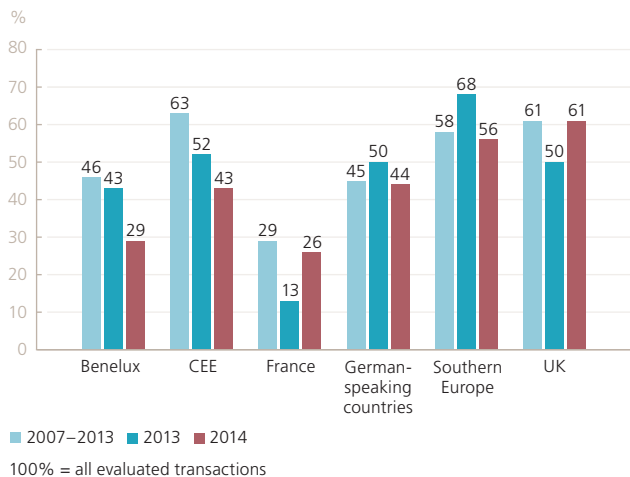
Liability caps 2013/2014



100% = all evaluated transactions

Liability caps (more than 50% of purchase price) 2007–2014

Time trend Europe

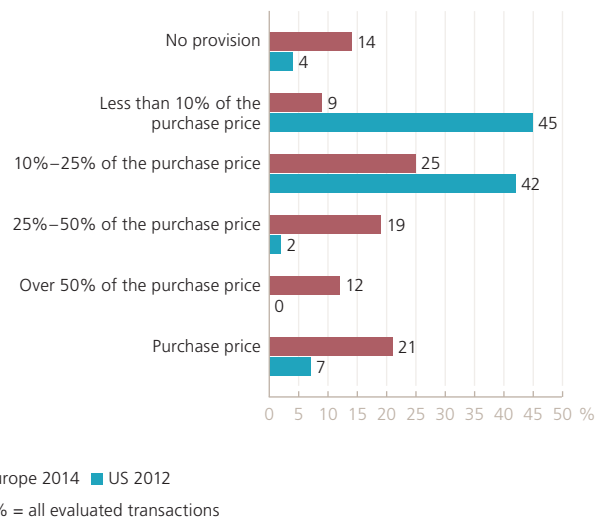


There are significant regional differences across Europe. While the sellers were able to reduce their liability caps across continental Europe in 2014 (compared with the period 2007–2013), the number of UK deals with a liability cap exceeding 50% of the purchase price remained at its 2007–2013 average, i.e. 61% after being only 50% in 2013.

In other regions (CEE, Southern Europe and Benelux) the number of deals with a liability cap exceeding 50% clearly decreased compared with 2013 (CEE: from 52% in 2013 to 43% in 2014; Southern Europe: from 68% in 2013 to 56% in 2014). Benelux (where only 29% of the deals have a liability cap exceeding 50% of the purchase price) is comparable with France (26% in 2014).

Liability caps are still significantly higher in Europe than in the US. The highest category (45%) of sellers' liability caps in the US is a liability cap of less than 10% of the purchase price. The second most frequent category (42%) was a liability cap of 10–25% of the purchase price. This means that (87%) of US deals had a liability cap of 25% or less of the purchase price. The equivalent in Europe for 'low cap deals' in 2014 was (34%), exactly the same as in 2013.

Liability caps Europe/US



“ Seller's liability caps are getting lower.

Warranty & Indemnity insurance

Warranty & Indemnity insurance

W&I deal features

<i>De minimis</i> for seller	0.1%
Basket threshold for seller	0.7%
– First Dollar	73.0%
– Excess only	27.0%
Liability cap of seller	5.0%
Limitation period of seller for warranty claims	19 months
Frequency of seller policy	19.0%
Frequency of buyer policy	81.0%
Proportion of policy coverage to deal size	33.0%
Proportion of liability not covered by policy	1.0%

Percentages greater than 1% are rounded up or down as appropriate.
These statistics are the mean of W&I deals where CMS has acted for the insurer.

W&I insurance has been available for many years, but has only broken through as a real solution in recent times. It provides a solution for the ‘warranty gap’ usually where sellers are not prepared to or in some cases unable to give warranties and indemnities. The product is particularly attractive to sellers in competitive auction processes. They are unwilling to provide warranties and indemnities, but can provide a package to prospective buyers which will enable them to make warranty claims against the insurer rather than the seller.

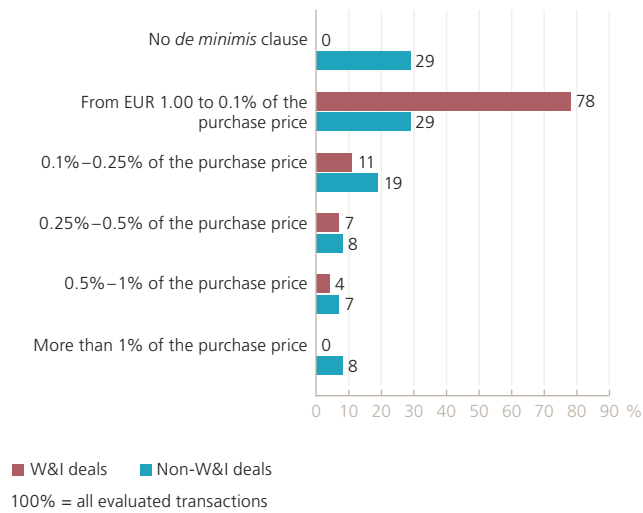
Will Hemsley, Partner of Hemsley Wynne Furlonge commented, “The number of transactions supported by W&I insurance continued to grow in 2014, with the key drivers for its use being the reluctance or inability of sellers to give significant liability caps or have funds tied up post sale. This was most prevalent in transactions involving private equity firms, real estate investors or infrastructure funds, especially as there remains the pressure to provide risk free returns to investors.”

Buyers have typically been sceptical of the ability of insurers to satisfy claims, but a growing claims history allays some of these fears. The key for buyers is the ability to obtain back-to-back cover for a full set of well negotiated warranties that have benefited from disclosure and due diligence.

CMS is one of the most active law firms acting for insurers on W&I deals advising insurers on some 100 deals per annum. These deals come in various shapes and sizes and, as with most data, very large transactions can distort statistics. However, the average outcomes displayed above are in our view an accurate reflection of the existing market.

We have in turn analysed the W&I deals where CMS has acted for the insurer and compared the outcomes against non-W&I deals which form part of the general data for this Study. The following attributes and differences of W&I deals amply display the difference in risk allocation between seller and buyer in those deals where W&I is used and those where it is not.

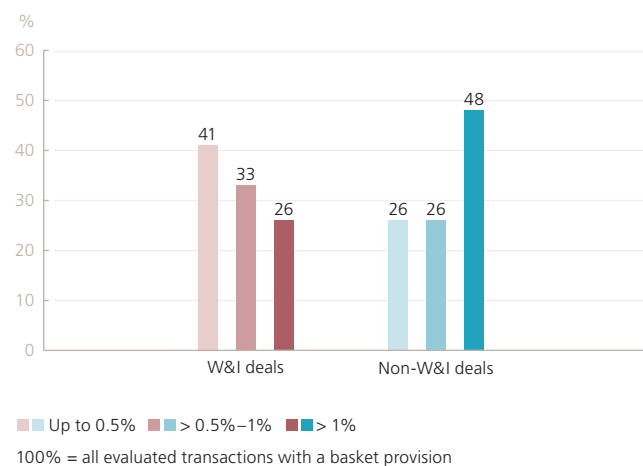
De minimis for 2014 W&I deals and Non-W&I deals



De minimis

The average *de minimis* for a seller in a W&I deal is 0.1%. Sellers tend to be in a better position on W&I deals given that in 78% of W&I deals the *de minimis* is 0.1% or less of the purchase price compared with only 29% in the case of non-W&I deals.

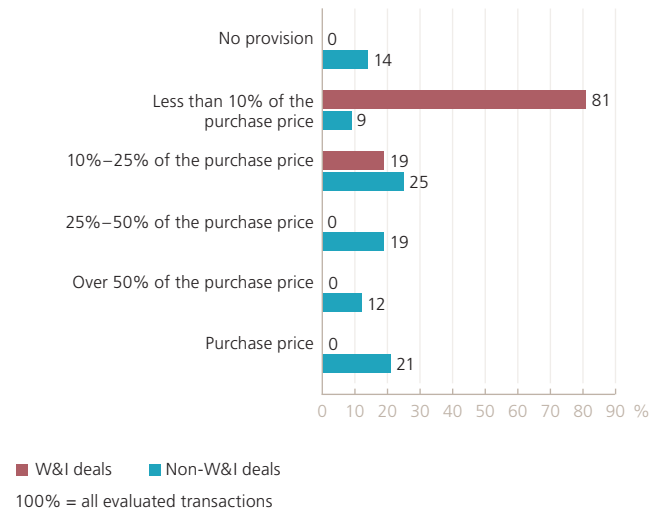
Basket thresholds for 2014 W&I deals and Non-W&I deals



Basket

The average basket threshold for a seller in a W&I deal is 0.7%. Again, this compares very favourably for sellers against non-W&I deals. In W&I deals 74% of basket thresholds are 1% or less of the purchase price compared to 52% in the case of non-W&I deals.

Liability caps for 2014 W&I deals and Non-W&I deals

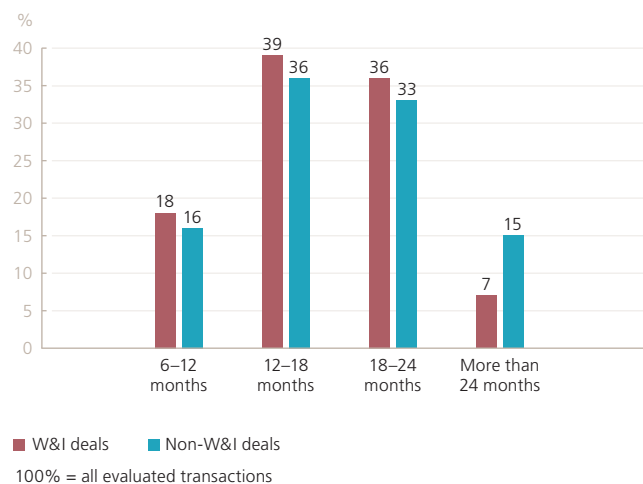


Liability cap

This is the area where there is clearly the most advantage for sellers and one of the principal reasons for sellers to be attracted to W&I deals. The average liability cap is a mere 5%. In 81% of W&I deals the liability cap is less than 10% of the purchase price compared with just 9% in non-W&I deals. The remaining 19% of W&I deals have a liability cap of between 10–25% of the purchase price compared with 25% in non-W&I deals. In other words, in W&I deals, 100% of cases have a liability cap of 25% or less compared with just 34% in the case of non-W&I deals. It is the buyer who takes on the residual risk since the policy is unlikely to cover 100% of the purchase price. The analysis on W&I deals provided for average policy coverage of 33% of the purchase price.

Warranty & Indemnity insurance (continued)

Limitation period for warranty claims for 2014 W&I deals and Non-W&I deals



W&I insurance continued to grow in 2014.

Limitation period for warranty claims

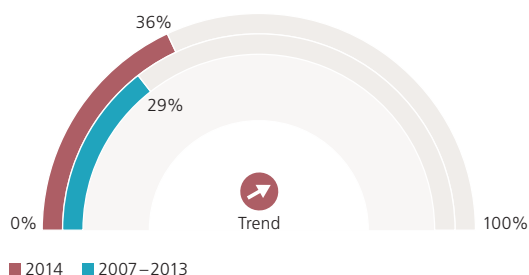
The limitation period for warranties is very similar in both W&I deals and non-W&I deals. On buy side policies, it is open to the buyer to extend its period of coverage beyond that which is contractually agreed by the seller in the sale agreement.

W&I insurance can be offered both for the seller and the buyer, but is more usually taken out by the buyer (81% of relevant deals in 2014) with the premium, typically between 1–2% of the cover purchased, often being borne in whole or in part by the seller.

Limitation period for warranty claims

CMS Trend Index

Limitation periods (12–18 months)



12–18 months warranty limitation period most common

The seller-friendly trend towards shorter limitation periods for warranty claims persisted in 2014. Limitation periods of 12–18 months were most frequently used (36% compared with 34% in 2013), while shorter periods than 12 months were used in 16% of the deals (2013: 14%). Limitation periods of 18–24 months increased from 26% to 33%, whereas limitation periods of more than 24 months decreased to 15% (2013: 26%). Together, limitation periods between 12–24 months were used in 69% of all deals compared with 60% in 2013.

CMS Sector Analysis

Limitation periods (more than 24 months)

Sector	2007–2013	2014
Banking & Finance	29%	9%
Hotels & Leisure *	35%	5%
Energy	25%	8%
Consumer Products	30%	26%
Technology, Media & Communications	25%	17%
Infrastructure & Projects *	26%	0%
Lifesciences	26%	13%
Real Estate & Construction *	40%	16%
Industry **	22%	15%
Business (other services) **	31%	30%
CMS average	28%	15%

100% = all evaluated transactions of the respective branch

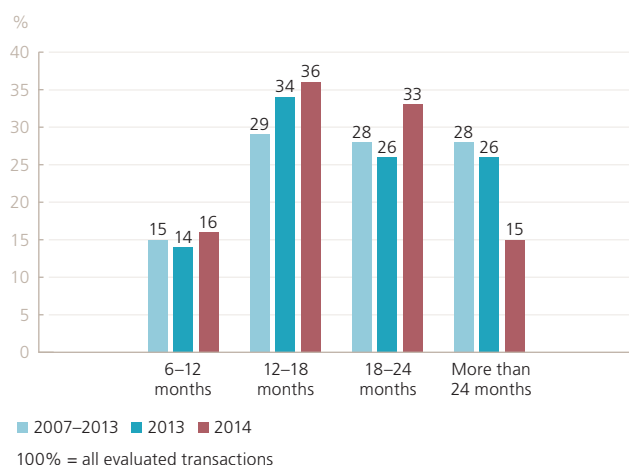
* no inquiry in 2007, 2008 ** no inquiry in 2009

Longest limitation periods in Business deals

Even in regions where the parties traditionally agree on long limitation periods (France and Southern Europe) sellers were able to avoid limitation periods of more than 24 months increasingly (France: 29% in 2014 compared with 49% in the period 2007–2013; Southern Europe: 23% compared with 44% in the period 2007–2013). Meanwhile, in other regions, sellers were able to successfully negotiate short limitation periods of 6–12 months in Benelux (26% of the deals in 2014) and CEE (23% of the deals in 2014).

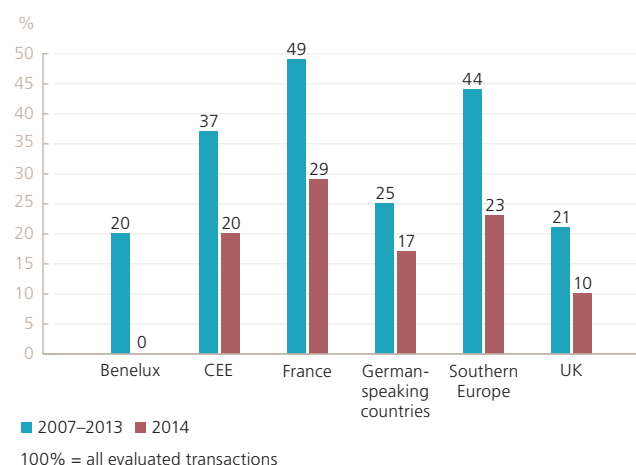
Long limitation periods are a particular feature of the Business and the Consumer Products sectors: 30% (Business) and 26% (Consumer Products) of the deals in these sectors had limitation periods of more than 24 months.

Limitation period for warranty claims 2007–2014



Limitation periods for warranty claims 2007–2014

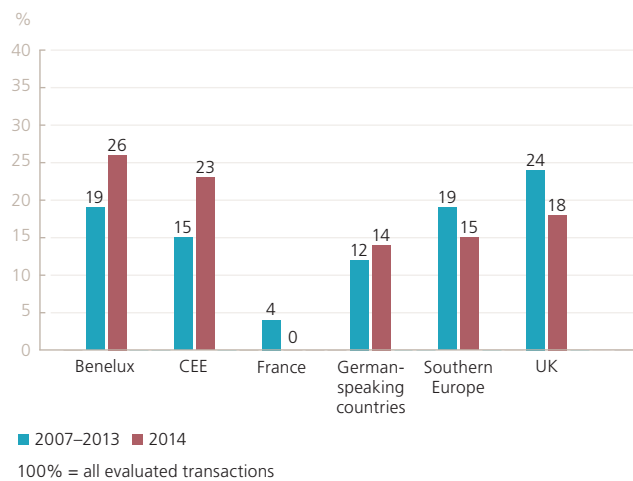
More than 24 months



Limitation period for warranty claims (continued)

Limitation periods for warranty claims 2007–2014

6–12 months

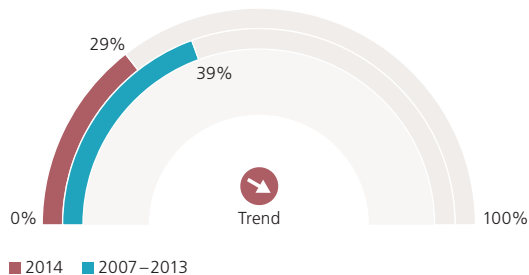


In 2014, limitation periods of 12–24 months were most commonly used.

Security for warranty claims

CMS Trend Index

Security for warranty claims

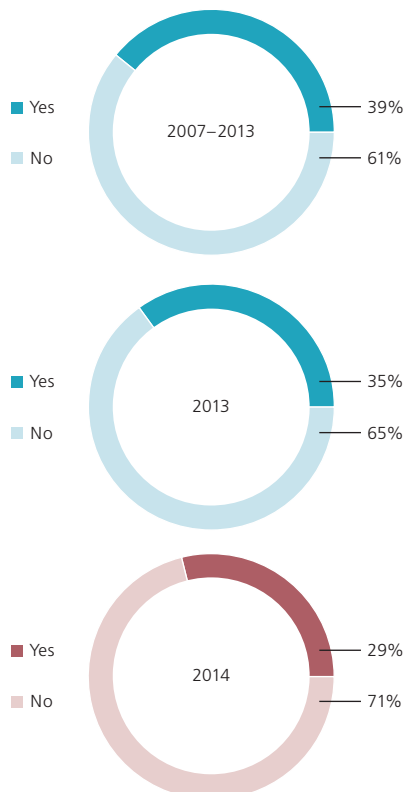


Buyers less concerned about security for warranty claims

Compared with the period 2007–2013, there was a seller-friendly decrease in the use of security for warranty claims. In 2014, 29% of buyers took some form of security for general warranty claims compared with 35% in 2013 and 39% for the overall period 2007–2013.

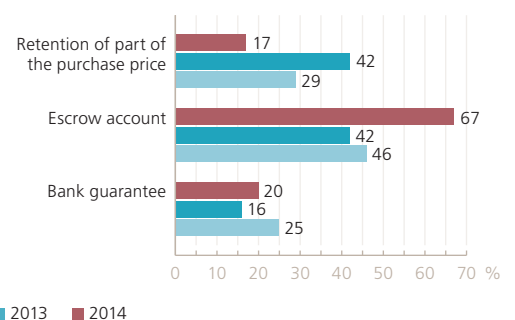
Where sellers and buyers agreed on a security for warranty claims, they most commonly decided to open an escrow account (67% in 2014 compared with 42% in 2013). On the other hand, the number of deals in which buyers were able to retain a part of the purchase price decreased from 42% in 2013 to 17% in 2014. This may lead to the conclusion that sellers were increasingly not willing to bear the insolvency risk of buyers during the limitation period for warranty claims in 2014. This again shows a stronger position for sellers in 2014 compared with 2013. The use of bank guarantees increased from 16% in 2013 to 20% in 2014. However, compared with the period 2007–2013 (25%), sellers were still reluctant to offer a bank guarantee.

Security for warranty claims 2007–2014



100% = all evaluated transactions

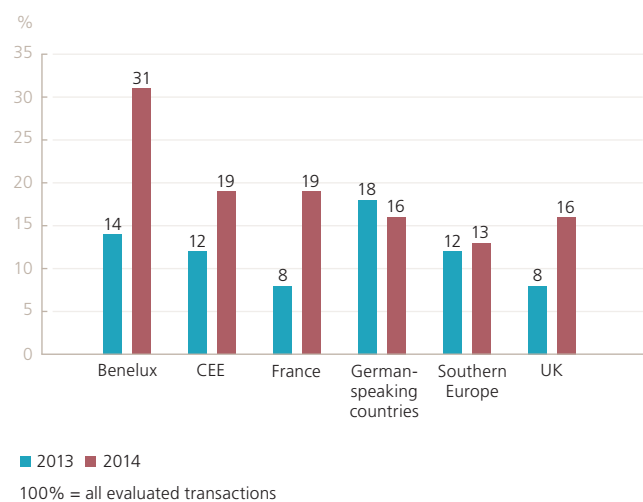
Security for warranty claims 2007–2014



100% = transactions with safeguarding mechanism – more than one nomination possible

Security for warranty claims (continued)

Escrow accounts 2013/2014

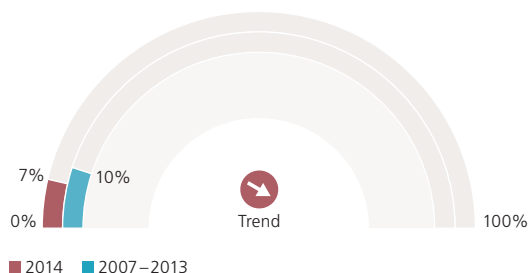


Buyers were less often looking to obtain some form of security.

Closing conditions

CMS Trend Index

Buyer's financing as closing condition



Decreasing number of deals conditional on buyer finance

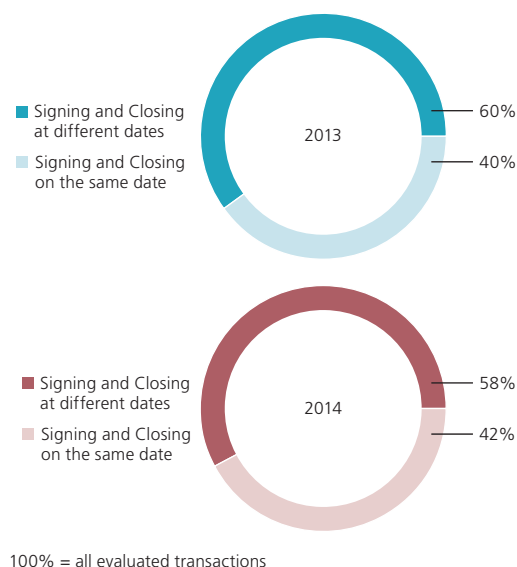
In 2014, signing and closing occurred on different dates in 58% of all evaluated transactions (60% in 2013). In these cases, parties agreed upon closing conditions in 91% of the deals concerned.

The most common specific conditions were regulatory approval and compliance (32%). It is noteworthy that there were a high number of "other" conditions (38%) to be satisfied between signing and closing.

These have included: confirmatory due diligence after signing; the need to restructure the target before closing (e.g. to carve-out certain assets of the target not being sold); and third party consent to the transaction (especially waivers of change of control rights).

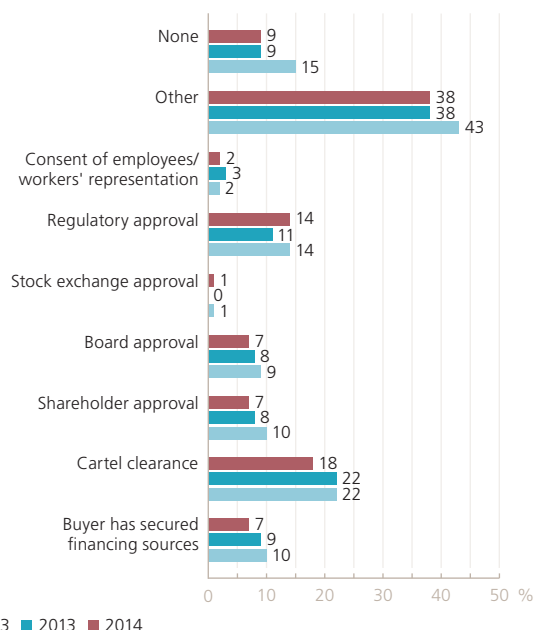
It is notable that the requirement of board approval or shareholder approval as a closing condition slightly decreased in 2014 (14% in 2014, compared with 16% in 2013). This may indicate that buyers and sellers are requiring the necessary approvals prior to signing.

Reference Date (Signing and Closing) 2014



100% = all evaluated transactions

Closing conditions 2007-2014



■ 2007-2013 ■ 2013 ■ 2014

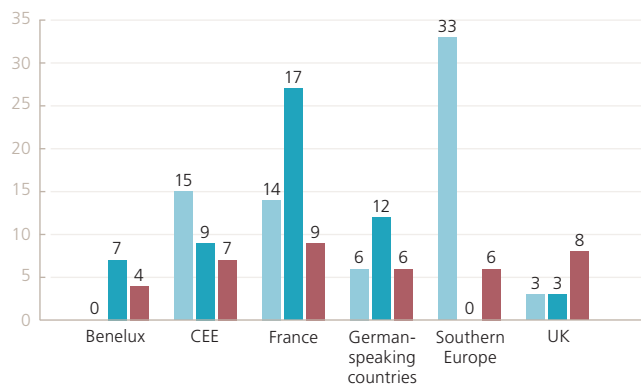
100% = all evaluated transactions – more than one nomination possible

Closing conditions (continued)

Closing conditions 2012–2014

Buyer's financing secured

%



■ 2012 ■ 2013 ■ 2014

100% = all evaluated transactions



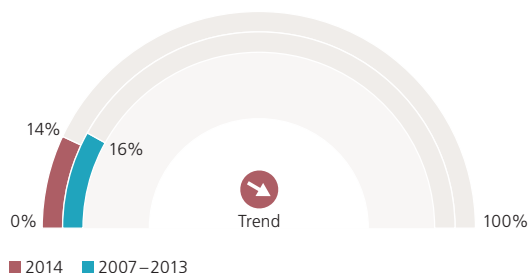
Sellers seemed to be requiring certainty of buyer's financing more often before signature in 2014.

In general the number of deals containing a condition on buyer's financing was below 10% in each region for the first time in the Study. This trend could be evidence that buyers were able to secure financing in good time due to either having the required cash or bank financing, or alternatively that sellers remain disinclined to sign deals whilst buyer financing is not secure. While in most countries in 2014, signing deals conditional on buyer's financing decreased; it was more frequent in the UK, climbing from 3% in 2013 to 8% in 2014.

MAC clause

CMS Trend Index

MAC clauses



Decrease in MAC clauses

Material Adverse Change clauses (MAC clauses) give the buyer the right to terminate the agreement if a specific event defined in the agreement with negative impact on the target business occurs before closing. In 2014, MAC clauses were used in 14% of the deals, reflecting a slight decrease compared with the period 2007-2013 (16%). This shows that sellers are ever more reluctant to give buyers a chance to rescind the agreement after signing.

CMS Sector Analysis

MAC clauses

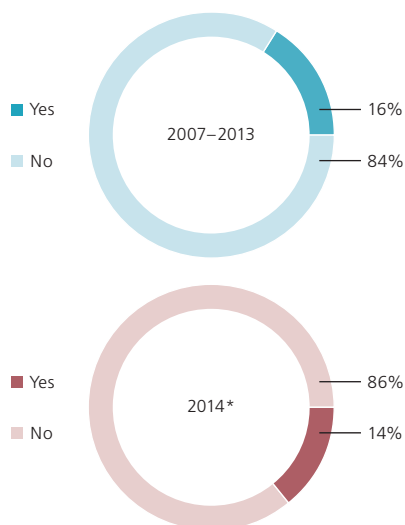
Sector	2007-2013	2014
Banking & Finance	19%	35%
Hotels & Leisure *	12%	10%
Energy	18%	18%
Consumer Products	21%	7%
Technology, Media & Communications	16%	3%
Infrastructure & Projects *	10%	8%
Lifesciences	18%	19%
Real Estate & Construction *	8%	14%
Industry **	18%	12%
Business (other services) **	16%	5%
CMS average	16%	14%

100% = all evaluated transactions of the respective branch

* no inquiry in 2007, 2008 ** no inquiry in 2009

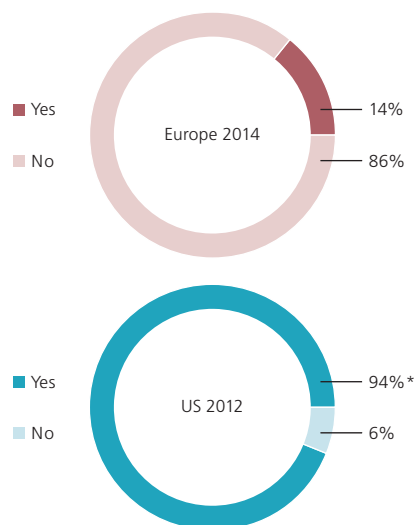
There was also no change regarding the fundamental difference in the use of MAC clauses in Europe compared with the US. While only 14% of European deals had a MAC clause in 2014, there were MAC clauses in 94% of US deals. The disparity in the use of MAC clauses between Europe and the US is very marked. It is partly explicable because of the seller's requirement for deal certainty on controlled auctions and also because there is, in certain jurisdictions, less of a MAC clause culture due to the greater number of transactions that sign and close simultaneously.

MAC clauses 2007-2014



100% = all evaluated transactions
* Result for 2013 is identical to 2014

MAC clauses Europe/US

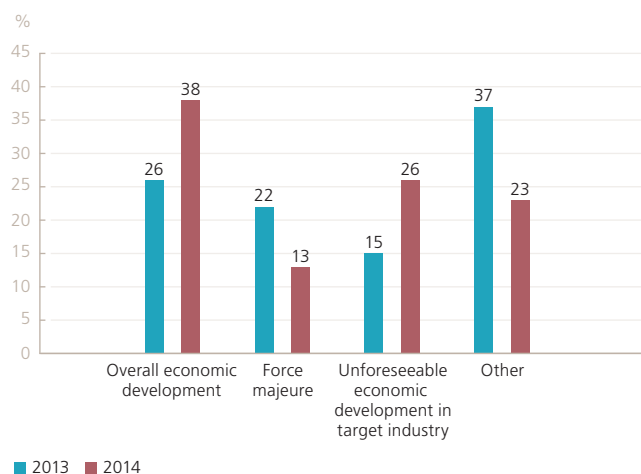


100% = all evaluated transactions
* 'Stand-Alone MAC', 'Back Door MAC' and mixed 'Stand-Alone/Back Door MAC'

MAC clause (continued)

MAC clauses 2013/2014

Exemptions from Material Adverse Change



100% = all transactions including a MAC clause – more than one nomination possible



MAC clauses much less common in Europe than in US.

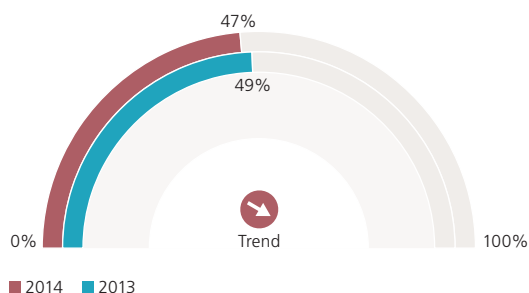
There were significant differences between specific sectors. In 2014, MAC clauses were particularly rare in certain sectors, namely Consumer Products, Infrastructure & Projects, Technology, Media & Communications. The Banking & Finance sector saw by far the most deals (35% in 2014), followed by Lifesciences (19%) and Energy (18%).

Where a MAC clause was used, in many cases the parties agreed that some events should not constitute a MAC. It is clear that in 2014, sellers were less successful in negotiating general carve-outs from MAC clauses. This decrease is noticeable in the case of force majeure and non-specified factors. On the other hand there is an increase of general carve-outs from MAC clauses for an overall economic development and/or for an unforeseeable economic development in the target industry from 41% (2013) to 64% (2014), being in line with the period 2007–2013.

Non-compete

CMS Trend Index

Non-compete covenants



Some decrease in non-compete covenants

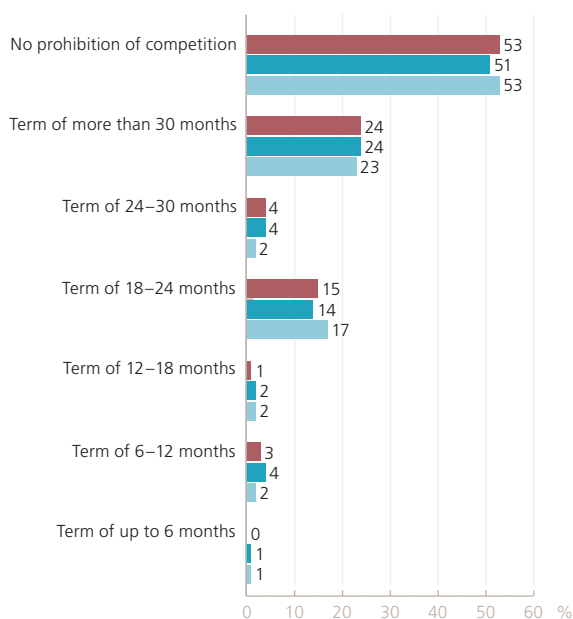
In recent years, the number of deals containing a provision which prohibits competition by the seller swayed around the 50% level. Despite the increased number of deals which contain clauses prohibiting competition from 46% to 49% in 2013, buyers could not sustain their success in negotiating non-compete covenants in 2014 (47%).

Compared with the period 2007–2013 (47%) there is no specific trend observable, as the transactions in 2014 hit the average. A short-term comparison to 2013 (49%) shows a slightly seller-friendly trend in 2014.

When the parties agreed a non-compete covenant, terms of more than 30 months were used most frequently (24%), followed by covenants with terms of 18 to 24 months (15%). Non-compete clauses with short terms of up to 18 months applied only in 4% of the deals.

Non-compete 2007–2014

Duration of non-compete clauses



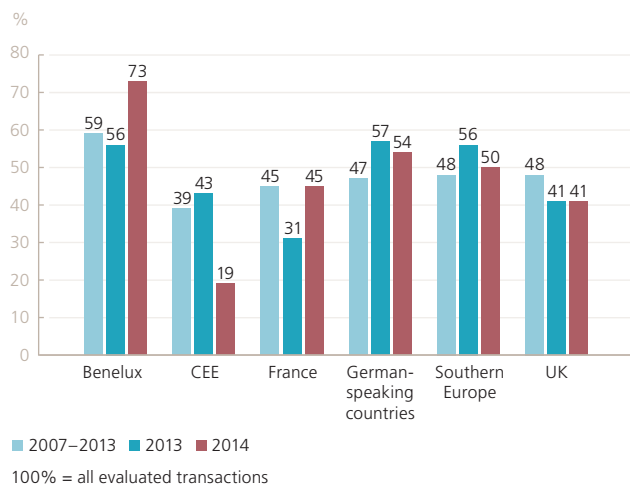
■ 2007–2013 ■ 2013 ■ 2014

100% = all evaluated transactions

Non-compete (continued)

Non-compete 2007–2014

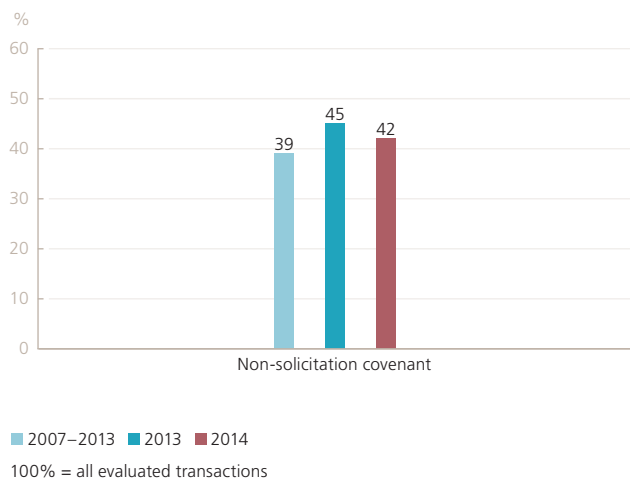
Deals containing a non-compete clause



During 2014, non-compete provisions were least likely in Central and Eastern Europe (19%) and most likely in Benelux, where the number of deals increased by seventeen percentage points to 73% compared with 2013, followed by German-speaking countries (54%) and Southern Europe (50%).

Non-solicitation 2007–2014

Non-solicitation covenant

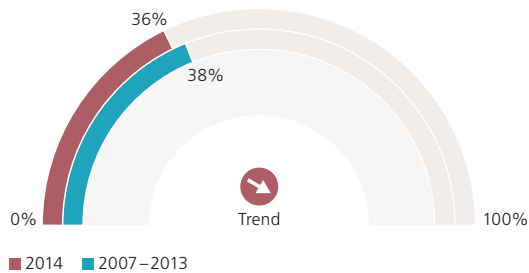


Non-solicitation

As well as the lesser number of deals containing non-compete provisions, non-solicitation covenants were also agreed less often in 2014 (42%) than in 2013 (45%). A comparison with the period 2007–2013 (39%) reveals that on average buyers are now more successful in negotiating a provision which prohibits solicitation.

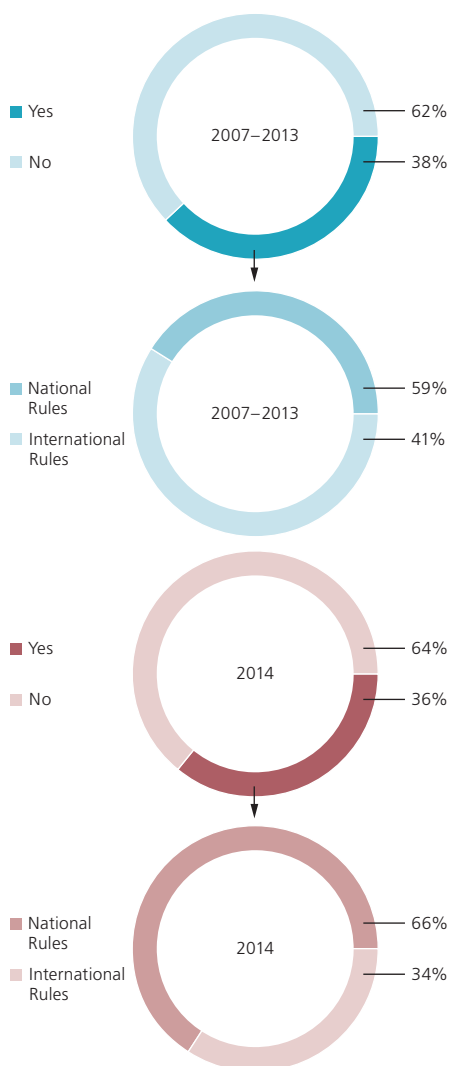
Arbitration

CMS Trend Index Arbitration



Arbitration broadly consistent

Arbitration clauses 2007-2014



100% = all evaluated transactions

Arbitration clauses mean that all disputes arising out of the deal would be decided before a private tribunal instead of a public court process (litigation).

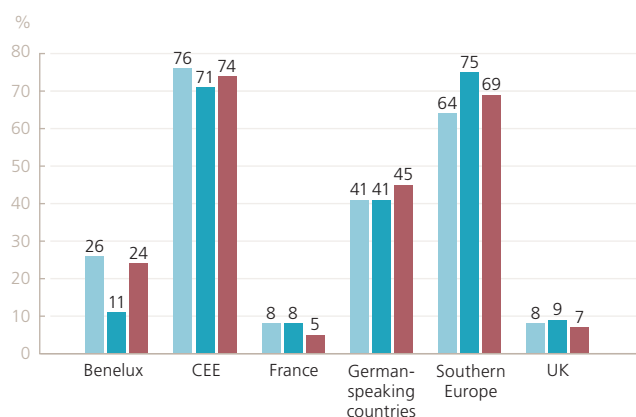
Reasons for preferring arbitration to litigation typically include a preference for a private dispute resolution mechanism or a desire to avoid courts in certain jurisdictions where the time, cost and predictability of the proceedings is uncertain. There are perceived downsides to arbitration, such as the relatively high costs of well-known arbitration institutions and concerns that potential efficiencies in the process are not achieved in practice.

After an increase of four percentage points from 33% in 2012 to 37% in 2013, there was a little less use of arbitration clauses in 2014 with 36% of all evaluated transactions containing an arbitration clause in 2014. Compared with the period 2007-2013 (38%) we saw slightly fewer transactions with arbitration clauses.

In all likelihood, the strongest driver for the choice of arbitration over litigation will relate to the need to obtain an award that can be enforced in multiple jurisdictions or jurisdictions where enforcement of foreign judgments may be more difficult.

Arbitration (continued)

Arbitration clauses 2007–2014



■ 2007–2013 ■ 2013 ■ 2014

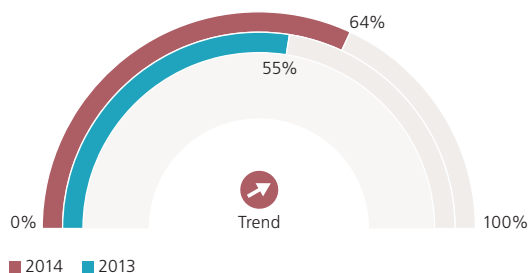
100% = all evaluated transactions



Compared with 2013, slightly fewer arbitration clauses were used in transactions.

Regional differences are notable. Arbitration clauses are – despite a decrease in 2014 – still popular in Southern Europe (69% compared with 75% in 2013), while parties traditionally agree on an arbitration mechanism in CEE (74% compared with 71% in 2013). On the other hand, arbitration is rarely used in France (5%) and in the UK (7%). In Benelux the popularity of arbitration clauses seemed to recover (24%) after a drop from 40% in 2012 to 11% in 2013.

CMS Trend Index Tax indemnity agreed



Buyer-friendly increase in tax indemnity clauses

The rationale behind a tax indemnification provision is that the buyer wants to be held harmless for pre-closing tax risk. 64% of the deals in 2014 contained this special tax indemnity (55% in 2013), resulting in a buyer-friendly increase of indemnity clauses.

The Study focuses on the different limitation periods for tax indemnity claims, namely 'absolute' limitation periods and 'relative' limitation periods. An 'absolute' limitation period bars tax claims by the buyer against the seller after a fixed date.

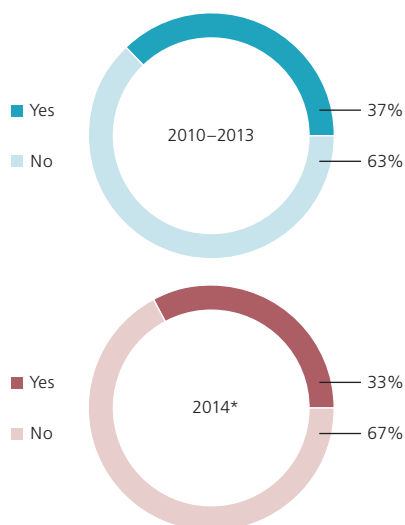
A 'relative' limitation period is directly related to a decision by the relevant tax authority. In these cases, the limitation period (which is then usually very short) does not start until a relevant decision of a tax authority has been made. Nevertheless, both approaches do often lead to the same result, as the majority of 'absolute' limitation periods are longer than five years post-closing and within this timeframe, most tax decisions have been issued by the relevant tax authorities.

There were significant regional differences in relation to tax indemnity clauses. Apart from the German-speaking countries, where 83% of all transactions with a tax indemnity clause had a relative limitation period, the parties mainly agreed on absolute limitation periods in most of the other evaluated regions except for Benelux (where 67% of the transactions had a relative limitation period). In the UK, in CEE and in France tax indemnities are exclusively limited by absolute periods.

Sellers were less successful in preserving a participation right in proceedings started by a tax authority. While in the period from 2010 up to 2013, sellers had such a right in 37% of all relevant transactions (i.e. those with a tax indemnity clause), they only had a participation right in 33% of such deals in 2013 and 2014. The buyer-friendly trend starting in 2013 gave rise to the lowest use of participation clauses since the Study began evaluating them – and this has remained the case in 2014.

Tax indemnity 2010–2014

Participation right at a future tax audit



100% = all evaluated transactions with a tax indemnity clause

* Result for 2013 is identical to 2014

Methodology

The Study includes deals which were structured either as a share sale or an assets sale, including transactions where a seller held less than 100% of the target company's share capital, provided this represented the seller's entire shareholding in the target company. The Study also includes property transactions which involved the sale or acquisition of an operating enterprise such as a hotel, hospital, shopping centre or comparable business, and not merely a piece of land. Internal group transactions were not included in the Study. The data has been divided for comparative purposes into four European regions. The countries included in each of these regions are as follows:

- Benelux: Belgium, The Netherlands and Luxembourg
- Central and Eastern Europe (CEE): Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Russia and Ukraine
- German-speaking countries: Austria, Germany and Switzerland
- Southern Europe: Italy, Spain and Portugal

France and the United Kingdom are presented as individual categories.

Transactions included in the Study cover the following sectors:

- Banking & Finance
- Hotels & Leisure
- Energy
- Consumer Products
- Technology, Media & Communications
- Infrastructure & Projects
- Lifesciences (Pharmaceutical, medicinal and biotechnical products)
- Real Estate & Construction
- Industry
- Business (Other Services)

Comparative data from the US was derived from the "2013 Private Target Mergers & Acquisitions Deal Points Study" produced by the Mergers & Acquisitions Market Trends Subcommittee of the Mergers & Acquisitions Committee of the American Bar Association's Business Law Section.

Sharing knowledge for clients

Market intelligence publications



European M&A Outlook 2014

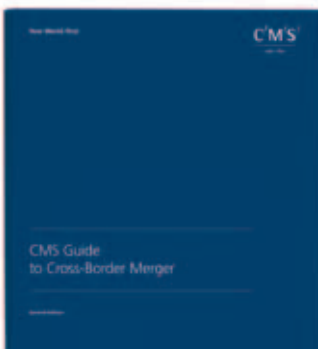
- Forward-looking research on the prospects for M&A across Europe for 2015
- Interview of Europe-based corporate executives
- Regional analysis for Benelux, CEE, German-speaking countries, Iberia, Nordics, SEE, France, Italy, Russia & Ukraine and UK & Ireland



Emerging Europe: M&A Report 2014/15

- Summary of the highlights of 2014 M&A activity
- Provision of deal activity predictions for 2015
- Regional break-down for 15 countries in Central and Eastern Europe (CEE)

Know-how publications



Cross-Border Merger Guide 2014

- Overview of the legal and fiscal requirements and consequences of cross-border mergers in Europe
- Country-specific timelines
- Including online planning tool for project teams
- Regional break-down for 19 European countries



Duties & Responsibilities of Directors 2015

- Overview of the rules relating to directorship and answering the most frequently asked questions for directors
- Regional break-down for 29 countries including also the non-European countries Brazil, China, Mexico, Oman, Russia, Turkey, United Arab Emirates and Ukraine

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