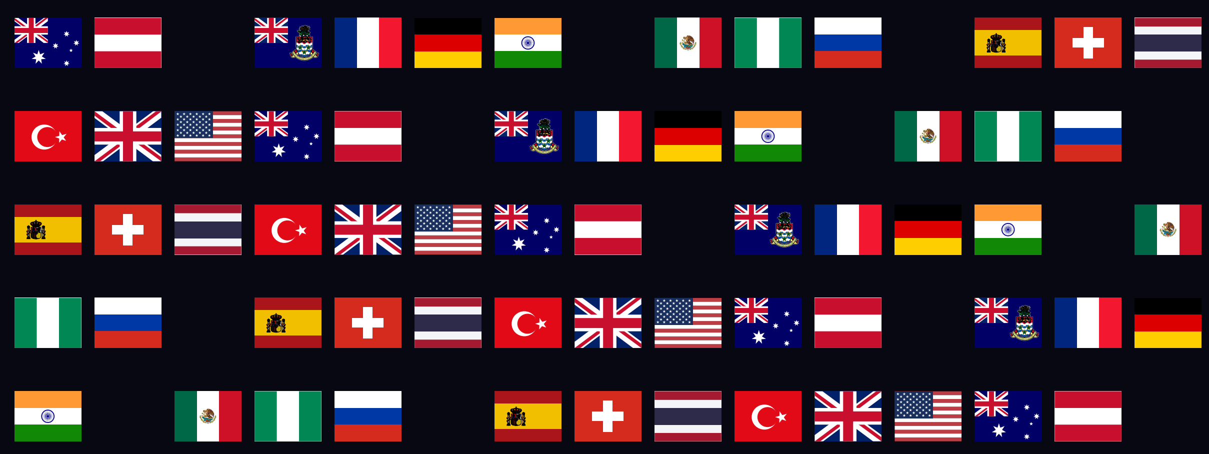
PRIVATE EQUITY (TRANSACTIONS)

Germany



LEXOLOGY
Getting The Deal Through

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Private Equity (Transactions)

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Quick reference guide enabling side-by-side comparison of local insights, including into types of private equity transaction; corporate governance, disclosure and timing considerations; dissenting shareholder rights; key purchase agreement provisions; participation of target company management; tax; financing; shareholders' agreements; exit strategies (including IPOs); target sectors; cross-border considerations; club/group deals; and key recent developments.

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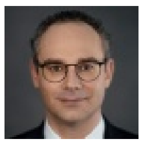

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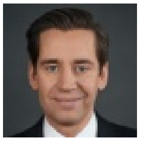

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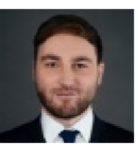

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TRANSACTION FORMALITIES, RULES AND PRACTICAL CONSIDERATIONS

Types of private equity transactions

What different types of private equity transactions occur in your jurisdiction? What structures are commonly used in private equity investments and acquisitions?

Predominantly, private equity investors aim to acquire majority stakes in German companies. However, given the lack of target companies and the mounting pressure on market to invest, private equity investors are nevertheless more and more willing to acquire minority interests as well.

Leveraged buyout transactions dominate the private equity market in Germany. But we have seen an increasing number of transactions in which private equity acquirers fully fund their investments with equity and get debt financing at a second stage. Lately we have also experienced an increasing number of add-on transactions of portfolio companies held by private equity investors as a consequence of buy and build strategy.

In most transactions, a private equity acquirer is willing to grant the management an equity portion in order to align interests with the management team. This management equity portion is in general, again, leveraged in comparison with the interest of the private equity acquirer.

Beside the acquisition of equity portions, we have also seen investment in other instruments such as profit participation rights or silent partnership interests. The private equity acquirer’s willingness to enter into such investments depends on the particular case and strategy.

Law stated - 25 January 2022

Corporate governance rules

What are the implications of corporate governance rules for private equity transactions? Are there any advantages to going private in leveraged buyout or similar transactions? What are the effects of corporate governance rules on companies that, following a private equity transaction, remain or later become public companies?

Private equity investors in Germany typically acquire private companies in leveraged buyout transactions that are organised as either limited liability companies, stock corporations or limited partnerships. The law provides for a framework of governance rules for each form of organisation, including for instance inalienable shareholder rights, necessary bodies or organs of the company, capital maintenance rules and requirements for insolvency filing.

The corporate governance rules imposed by statute are stricter for stock corporations and much more flexible for limited liability companies and limited partnerships. The strictest and most limiting corporate governance rules apply to listed companies, which have to be organised as a stock corporation (AG), a Societas Europaea (SE) or a limited partnership of shares (KGaA): for example, listed companies are required to comply with the codified corporate governance rules set out in the German Corporate Governance Code, last amended in March 2020, and with reporting and disclosure requirements on sensitive information that private equity investors typically do not want to share publicly. The governmental commission presented a new amendment to the German Corporate Governance Code in December 2019, which was adopted in March 2020. Inter alia, the rules for the remuneration of the board of directors and the independence of the advisory board have been strengthened. The board of directors is also urged to call for an extraordinary general meeting in the case of a takeover offer in order to allow the shareholders to discuss the offer and potentially to take necessary corporate measures.

As a result, private equity sponsors typically aim for acquiring or transforming the target company into a limited liability company in order to preserve maximum flexibility. In a limited liability company more specific corporate governance

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rules are usually set out and agreed in the corporate documents (ie, articles of association, partnership agreement, shareholder agreement, rules of procedure for management, etc) of the target company. These further rules aim to increase control over management and limit its power. The rules that are imposed on management in addition to statutory requirements are mostly driven by the responsibilities of the private equity sponsors to supervise and control the management of the target companies in accordance with their internal portfolio guidelines.

Typically, private equity sponsors will only accept the stricter governance rules that apply to the target company after its transformation into an AG for an exit through an initial public offering.

Law stated - 25 January 2022

Issues facing public company boards

What are some of the issues facing boards of directors of public companies considering entering into a going-private or other private equity transaction? What procedural safeguards, if any, may boards of directors of public companies use when considering such a transaction? What is the role of a special committee in such a transaction where senior management, members of the board or significant shareholders are participating or have an interest in the transaction?

The issues the board of directors of public companies face when considering entering into a transaction depend on the role of the public company within the transaction:

- If the listed company acts as a seller the board of directors represents the company in the negotiations and preparation of the transaction and also in the conclusion of the agreements to implement the transaction. If the transaction or the preparation of a transaction is to be considered as insider information for the (selling) listed company, the board of directors has to make an ad hoc announcement in order to inform the market of the intended sale of the target. Under certain prerequisites management may decide on a deferral of such ad hoc announcement to avoid disadvantages in the selling process. However, such a decision on the deferral needs to be documented in minutes and supported by the board. Decisions on allowing potential buyers to undertake due diligence on the target have to be carefully considered and the information presented in the due diligence has to be thoroughly selected. Management has to ensure that no insider information is being passed on to the potential buyers of the target in the due diligence process. The board of directors must also consider that allowing a due diligence already requires approval by the supervisory board according to the corporate governance guidelines, which is typically the case. To avoid personal liability and to enable the supervisory board to perform proper control over management (but not for the legal effectiveness of the transaction) the board of directors typically requires an approving resolution of the supervisory board before signing the deal. In rare cases, however, where the listed company sells its major assets in the transaction, a shareholder resolution needs to be obtained in order for the transaction to become legally effective.
- If the listed company is the purchaser of the target the board of directors has to consider at what point in time the preparation or conclusion of the transaction becomes insider information that requires an ad hoc announcement to the market. The board of directors may also make a decision on a deferral. A resolution of the supervisory board is required before the actual signing of the transaction, and not only for legal effectiveness but also to enable proper control of management by the supervisory board.
- If the listed company is the target of an attempted public take-over, the board of directors has to decide on allowing the potential bidder to undertake due diligence. It has to decide if and what information can be provided to a bidder without violating the company's interests and without passing on insider information. This decision can already require approval by the supervisory board, to avoid personal liability for the management. In any case, it is at least advisable that every decision of the board of directors is supported by a resolution of the supervisory board. The board of directors is allowed to take pre-bid defensive measures as well as certain post-bid defensive

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measures in accordance with the Securities Acquisition and Takeover Act and the Stock Corporations Act, but the rules are strict and in general, the board of directors is rather limited in taking any defensive measures against a hostile takeover. In any event, the board of directors and the supervisory board have to give a public statement and give comments on the evaluation of the public takeover offer from their perspective.
- Disregarding the role of the company in the transaction if any benefits are gained by or promised to the board of directors in connection with the transaction, such benefits need to be disclosed and a conflict of interest shall not affect the decision of the board, otherwise, the board could face personal liability.

Law stated - 25 January 2022

Disclosure issues

Are there heightened disclosure issues in connection with going-private transactions or other private equity transactions?

If the target company is publicly listed, an investor must notify the target company and the Federal Financial Supervisory Authority (BaFin) once it obtains or surpasses 3, 5, 10, 15, 20, 25, 30, 50 and 75 per cent of the target's voting rights pursuant to the Securities Trading Act. In turn the target company has to publish the voting rights of the investor. The obligation to notify also applies if the voting rights are held indirectly (eg, through financial instruments). Investors reaching 10 per cent of the voting rights in a listed company must inform the target company of their intended objectives and their source of funding within 20 trading days. The investor must further specify its intentions with respect to:

- its strategic goals or returns from investing;
- the acquisition of additional voting stock in the next 12 months;
- exerting influence on the company's management or supervisory board; and
- the substantial modification of the capital structure of the target.

In turn, the target company needs to disclose such information to the public.

If more than 25 per cent or the majority of shares in an unlisted German AG are acquired, the acquired company must be notified. The same applies in the case of a shortfall of these thresholds. In the case of a failure to meet such requirements, the shareholder may not exercise the voting rights from its shares.

When shares in a limited liability company (GmbH) are acquired, a new list of shareholders has to be registered with the competent commercial register, which is publicly available. Any new partner to a partnership needs to be registered with the competent commercial register.

As of 1 January 2020, further filing requirements have been established for acquirers of shares pursuant to an amendment of the Money Laundering Act. All legal entities governed by private law have to file certain data with the Transparency Register, inter alia regarding the beneficial owners in the company (ie, persons directly or indirectly holding more than 25 per cent of the shares or control more than 25 per cent of the voting rights or exercising control in a comparable way (eg, by voting trust or pooling agreements)). Violation of the filing obligation is punishable by a fine.

In mergers and acquisitions transactions in which the management of alternative funds (AIFM) are involved disclosure requirements pursuant to the Capital Investment Act must be considered. When such AIFM acquires, disposes or holds shares of a non-listed company on behalf of an of alternative investment fund (AIF), the AIFM must notify BaFin of the proportion of voting rights of the non-listed company held by the AIF any time that portion reaches, exceeds or falls below the thresholds of 10, 20, 30, 50 and 75 per cent. When an AIF, individually or jointly, acquires control over a non-listed company or an issuer the AIFM managing such AIF must notify the non-listed company concerned, the

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shareholders of the company and the competent authorities of the home member state of the AIFM, and must make available further information with respect to inter alia the situation regarding the voting rights at the time of acquiring control, the policy for preventing and managing conflicts of interest and the policy for external and internal communication relating to the company in particular as regards employees, its intentions with regard to the future business of the non-listed company and the likely repercussions on employment, including any material change in the conditions of employment. The company needs to inform the employees' representatives or, where there are none, the employees themselves, without undue delay of the information.

According to the Foreign Trade Act and the relevant ordinance, the Federal Ministry of Economics and Energy (BMWi) needs to be informed if the investor originates from outside the European Union or the European Free Trade Association.

According to the merger control provisions of the German Act against Restraints of Competition, transactions have to be disclosed to the Merger Control Authority if the parties to the transaction meet certain thresholds.

Law stated - 25 January 2022

Timing considerations

What are the timing considerations for negotiating and completing a going-private or other private equity transaction?

Typically, private equity and going-private transactions are advised by investment banks or mergers and acquisitions (M&A) advisers.

The acquisition of private companies is usually organised in auction processes coordinated by the seller's M&A advisers. The duration of such a transaction (including the planning phase and post-closing measures) varies from a few weeks up to several months, depending on the individual circumstances, such as the size of the transaction, transactional and financing structures, time pressure on the buyer's or seller's side and if public approval or clearances (eg, antitrust) are necessary. The timeline for the auction is set out by the M&A advisers organising the process. The auction process begins with sending out teasers to potential buyers and conclusion of a non-disclosure agreement. Interested bidders gain access to an information memorandum containing basic financial and legal information about the target company and are then asked to submit non-binding offers outlining their ideas regarding the purchase price and transaction structure. Certain bidders are then selected and are granted access to a data room to perform due diligence on the target, which, depending on the size of the transaction, takes one to three months. After the due diligence the bidders are requested to submit binding offers including a mark-up of the sale and purchase agreement provided by the seller. The seller then enters into negotiations with its preferred bidders. While the negotiations between the seller and the bidder take place, the bidder is typically simultaneously negotiating financing and warranty and indemnity (W&I) insurance for the transaction. These side negotiations usually set the minimum time frame for the negotiation between the seller and the bidder as these elements are a prerequisite for signing the transaction. The conclusion of the sale and purchase agreement (the Signing) and the actual transfer of the shares (the Closing) are typically done in two separate steps, as the transfer in rem of the shares in most transactions is subject to the payment of the purchase price and other conditions precedent (eg, merger control clearances and other public approvals). If merger control clearance is required there is period of at least one month between the Signing and the Closing, as this is the time frame within which the Federal Cartel Authority may review the transaction and declare clearance or denial.

To take a publicly listed company private the acquisition of shares by a private equity investor are typically initiated through a block trade by which – outside the stock exchange – the acquisition of a bigger share package is being negotiated with one or several major shareholders. This is then combined with a public tender or takeover offer to obtain control over the publicly listed company. In any event, if a party obtains control of a public company either through a block trade purchase on the stock exchange or a public tender (ie, acquires at least 30 per cent of its voting

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rights, as defined by the Takeover Act), a public takeover offer becomes mandatory. This requirement needs to be considered if a private equity investor acquires or intends to acquire a substantial participation in a publicly listed target. Once the investor obtained control or the intention of the investor to make a public offer has been announced, the process for the takeover offer normally takes about 12 weeks (maximum up to 22 weeks). The duration of possible stakebuilding measures or a due diligence review before control is obtained or an announcement of an offer is made varies widely depending on the individual circumstances. To efficiently take a publicly listed company private (ie, not only cancel the listing with the stock exchange but also have no further minority shareholders in the company), private equity investors in Germany aim to acquire 100 per cent of the shares in the target. However, it is almost impossible to acquire 100 per cent of the shares in the target through a public takeover offer, as not all shareholders will accept the offer. In this case German law provides for procedures to squeeze out the minority shareholders. However, the prerequisites for a squeeze-out of minority shareholders are very strict and formal: the investor needs to hold at least 90 per cent or 95 per cent of the share capital in the target company and must pay or offer adequate cash compensation to the minority shareholders. Depending on the legal grounds for the chosen procedure to squeeze out the minority shareholders, the preparation (in particular the report on the adequacy of the offered cash compensation) and execution of the squeeze-out can take several months. If the minority shareholders dissent or object to the squeeze-out and exhaust their legal remedies to appeal, the timeline for the squeeze-out is significantly extended.

Law stated - 25 January 2022

Dissenting shareholders' rights

What rights do shareholders of a target have to dissent or object to a going-private transaction? How do acquirers address the risks associated with shareholder dissent?

Shareholders of a target are protected against going-private transactions in several ways. First of all, any bidder acquiring, directly or indirectly, 30 per cent or more of a listed (on an organised market) target's voting rights must make a mandatory offer to the remaining shareholders of the target to acquire their shares according to the Takeover Act. In this public takeover offer, the bidder must offer adequate consideration to the remaining shareholders, which can be challenged by the shareholders and reviewed in court. However, this right for each individual shareholder does not prevent the completion of the transaction itself, as it only leads to a review of the compensation. This may be different when a bidder makes an offer under the condition of reaching a certain number of voting rights with the offer. Typically, bidders aim to acquire 75 per cent of the voting rights or 90 or 95 per cent of the share capital, so following the public offer the bidder is able to actually take the company private and initiate substantial corporate measures such as a delisting, statutory mergers, domination and profit and loss transfer agreements or squeeze-out resolutions, etc. If the required quota in the public offer is not reached, the transaction fails. However, individual shareholders who do not hold enough shares to jeopardise the threshold will not be able to dissent or object to the transaction. Minority shareholders can only decide to either sell their shares or remain shareholders in the company.

Following a public offer, if a corporate taking-private transaction of the bidder requires a shareholder resolution and registration with the commercial register for its effectiveness (as is the case with, for example, mergers, change of legal form and corporate squeeze-outs), minority shareholders may try to interfere by taking action against the validity of the resolution (for example, the squeeze-out resolution) by filing a suit to set aside the shareholders' resolution for violating the law or the articles of association. Such litigation is mostly manageable for the company and the bidder by taking advantage of a special release proceeding. The rights of minority shareholders to challenge the validity of a resolution may only hold up the transaction, but will not be able to finally prevent it. However, the possibility of a going-private transaction being held up can affect the decision of bidders to launch an offer in the first place, as time can be essential (eg, for financing). Claims of minority shareholders with the aim of receiving additional compensation usually do not impede the effect of the squeeze-out itself (except for the takeover-related squeeze-out).

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Purchase agreements

What notable purchase agreement provisions are specific to private equity transactions?

In general, purchase agreement provisions in private equity transactions are similar to other common purchase agreement provisions for acquiring shares in companies. Nevertheless, there are certain specific aspects, which are regularly included in purchase agreements when private equity acquirers are involved.

For example, private equity investors as sellers are typically reluctant to provide operational representations and warranties. Therefore, private equity sellers regularly demand the purchaser to take out W&I insurance to limit possible liability under the sale and purchase agreement. In very rare cases, the management of the target company agrees on a separate warranties' agreement with the buyer, as the management has better insight into the business operations of the target

Private equity acquirers on the other hand often ask for special warranties with regard to environment, data protection, social, compliance and governance standards, sometimes directly relating to the United Nations Standards of Responsible Investment.

When it comes to deal certainty, sellers demand security of the financing from private equity acquirers that may for tax reasons be challenging private equity funds. Therefore, private equity funds usually enter into an equity commitment letter in favour of their special purpose vehicle, which acts as the acquiring entity in the transaction.

Law stated - 25 January 2022

Participation of target company management

How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues? Are there timing considerations for when a private equity acquirer should discuss management participation following the completion of a going-private transaction?

In general, there are no differences between going-private transactions and other private equity transactions regarding future management participation. Nevertheless, there might be specific issues with regard to compensation or management participation arising from specific regulatory provisions applicable to listed target. These provisions no longer apply after the delisting of the target.

The existing service agreements of the management team members are usually renewed. A private equity acquirer normally offers to increase compensation, as well as to set a fixed time period for the service agreement of up to five years.

Beside the service agreements of the management team members, which usually include bonus provisions in connection with operational and financial targets, a private equity acquirer intends to incentivise the management team on a successful exit. This is usually done by offering either an equity participation or an exit bonus. A manager's equity stake is mostly legally held by a pooling vehicle in the legal form of a limited partnership or by a trust company via a trusteeship. In smaller deals the managers occasionally hold their shares directly (or indirectly via an investment vehicle). In any event, equity participations are structured in order to minimise the risk of the tax authorities arguing that profits from the equity participation are treated as employment income and, therefore, a higher tax rate applies. On the other hand, an exit bonus is treated as employment income. When structuring a management participation, it should be avoided to trigger an initial taxation upon acquisition of the participation, as the manager has not yet

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received any funds to pay such taxes (dry income). Any taxes should therefore only be incurred once the manager has received the necessary funds to pay the tax. In private equity transactions, this is regularly the case at the time of an exit. The risk of initial taxation arises in particular, if the management acquires the participation at a discount.

Generally, a private equity acquirer should contact the management of the target company as early as possible in order to be able to agree with the management on a term sheet or even a shareholders' agreement until the signing of the share purchase agreement has taken place. Early discussions on management's participation also offer the possibility to convince the management team of the private equity fund. This can be a relevant advantage in an auction process.

Law stated - 25 January 2022

Tax issues

What are some of the basic tax issues involved in private equity transactions? Give details regarding the tax status of a target, deductibility of interest based on the form of financing and tax issues related to executive compensation. Can share acquisitions be classified as asset acquisitions for tax purposes?

The basic tax issues that private equity acquirers face in their transactions are, on the one hand, the ability to use the expenses and losses of the acquisition vehicle such as interest costs and, on the other hand, the tax-efficient reorganisation to forward the profits of the target company to the acquisition vehicle. This can be achieved, subject to certain limitations, by the formation of a fiscal unity between the acquisition vehicle and the target company. Therefore, the taxable result of the target company is attributed to the holding company if certain requirements are met (eg, execution of a profit transfer agreement). With respect to interest costs, which are an issue in leveraged buyout transactions, German law limits the deductibility of such expenses up to the amount of interest earnings and above up to a maximum of 30 per cent of the earnings before interest, taxes, depreciation and amortisation tax (EBITDA). The limitation does not apply if the interest costs are less than €3 million, the company is not part of a fully consolidated group or it has an equal or higher equity ratio as the group itself, whereby 2 per cent below is insignificant.

Additionally, under German law the losses of the target for direct or indirect acquisitions of 50 per cent of the shares within a period of five years, which typically applies to private equity participations, are in total not deductible.

Further, if the target company owns real estate, the indirect or direct acquisition of at least 90 per cent of the shares of the company may cause real estate transfer tax between 3.5 per cent and 6.5 per cent, whereby the tax calculation base is the partial value of the real estate.

Law stated - 25 January 2022

DEBT FINANCING

Debt financing structures

What types of debt financing are typically used to fund going-private or other private equity transactions? What issues are raised by existing indebtedness of a potential target of a private equity transaction? Are there any financial assistance, margin loan or other restrictions in your jurisdiction on the use of debt financing or granting of security interests?

Senior loans provided by traditional banks are the most common way of financing private equity transactions. A growing amount of senior loan financing is provided by alternative financing providers such as debt funds, which have higher interest margins and usually request the opportunity to also invest through additional mezzanine or equity financing instruments to achieve higher margins. In larger transactions, high yield bonds can be seen, but this form of

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financing is commonly used by strategic investors.

Existing indebtedness of the target company is usually fully exchanged and refinanced in the acquisition, as lenders to the acquiring company aim to obtain full access to existing securities and the cash flow of the (operative) target company. However, upstream guarantees and securities by subsidiaries (target companies) issued to their parent company (acquiring company) interfere with German capital maintenance rules. Therefore, it takes some effort to structure a debt-push-down, which is typically achieved through a profit and loss agreement or a merger between the target and the acquiring company.

Law stated - 25 January 2022

Debt and equity financing provisions

What provisions relating to debt and equity financing are typically found in going-private transaction purchase agreements for private equity transactions? What other documents typically set out the financing arrangements?

To take a publicly listed company private, a public takeover offer has to be initiated. The bidder is required to transmit an offer document to the Federal Financial Supervisory Authority (BaFin) and to publish the offer. For the public offer, an independent financial services institution (eg, an investment bank) needs to provide a letter confirming the availability of sufficient funds to pay for the offer (ie, the bidder needs to have sufficient financing to purchase all outstanding shares in the target company). As the financial services institution may be held liable if the bidder is unable to pay for the respective shares, the bidder needs to have and prove enough debt and equity financing for the financial services institution to submit such a confirmation letter.

Law stated - 25 January 2022

Fraudulent conveyance and other bankruptcy issues

Do private equity transactions involving debt financing raise ‘fraudulent conveyance’ or other bankruptcy issues? How are these issues typically handled in a going-private transaction?

There is no legal institution in the German legal system comparable to the fraudulent conveyance law known, for example, in the United States. In Germany, the protection of creditors is ensured mainly by capital maintenance rules, the insolvency contesting rules and the obligation to file for insolvency if the company becomes overindebted or illiquid. In addition, there are also accompanying legal institutions developed in case law, such as the prohibition for shareholders to take existence-destroying interventions. The provisions of German corporate law, however, are not sufficient to protect the creditors properly against the risks resulting from excessive debt financing: the capital maintenance rules are, for example, only addressed to shareholders. The financing banks are not addressed by the relevant prohibitions. Moreover, the creditors of limited liability companies are, under the Limited Liability Companies Act, only protected against the occurrence of a loss in share capital, but not against other actions that may disadvantage creditors.

More comprehensive creditor protection is provided by the insolvency contesting rules intended to reverse transactions that harm all creditors, or that favour individual creditors to the detriment of the others. In contrast to fraudulent conveyance, a disadvantageous legal act prior to the opening of insolvency proceedings alone is not sufficient under the Insolvency Act to substantiate a contest. The Insolvency Act contains various contestation reasons that have to be fulfilled additionally. Of particular importance is the possibility to contest a transaction owing to wilful disadvantage. On this basis, particularly high-risk transactions or transaction structures that are likely to cause insolvency of the company can be reversed by a liquidator.

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SHAREHOLDERS' AGREEMENTS

Shareholders' agreements and shareholder rights

What are the key provisions in shareholders' agreements entered into in connection with minority investments or investments made by two or more private equity firms or other equity co-investors? Are there any statutory or other legal protections for minority shareholders?

With regard to protections of minority shareholders, German corporate law provides information, monitoring and examination rights as well as the right to request a shareholders' meeting, depending on the legal form of the company in each case, to a greater or lesser extent. In addition, under German law the amendment of the purpose of the company is subject to the mutual consent of all shareholders, if not otherwise explicitly provided for in the articles of association. Other substantial amendments to the articles of association require qualified majorities. For example, capital increases require the consent of a qualified majority of 75 per cent of the shareholders' votes in the shareholders' meeting of a limited liability company and a qualified majority of at least 75 per cent of the share capital in the general meeting of a stock corporation (AG), whereby solely the articles of association of an AG may provide for a lower majority requirement (a simple majority).

Besides these statutory minority shareholders' protection rights, a private equity firm, as a minority investor, will ensure to agree upon further minority rights in a shareholders' agreement with private equity co-investors or other shareholders. These include rights such as veto rights, information rights and reporting obligations of the target's management, as well as non-compete and non-solicitation provisions. Regarding the target's shares, the private equity investor will ensure that transfer restrictions, rights of first refusal, drag-along rights, tag-along rights and, as the case may be, call and put options are in place. In any event, the private equity investor will ensure that it can exit its (minority) interest at its own discretion, usually by triggering an exit for all shareholders.

Law stated - 25 January 2022

ACQUISITION AND EXIT

Acquisitions of controlling stakes

Are there any legal requirements that may impact the ability of a private equity firm to acquire control of a public or private company?

Besides antitrust regulations and the reporting obligations and review procedures contained in the Foreign Trade Act, there are certain limitations and obligations for private equity firms in larger transactions that fall under alternative investment fund regulations after acquiring control of a non-listed company. For a period of 24 months following the acquisition the private equity purchaser is prevented from stripping any assets from the target company that may have an impact on the ability to finance the transaction.

In the case of publicly listed companies, the Takeover Act has an effect: if a private equity firm gains control of a public company (ie, acquires at least 30 per cent of its voting rights), it is, obliged to submit a mandatory public offer to the remaining shareholders of the target to acquire their shares pursuant to the Takeover Act. In certain cases, the voting rights from shares held by third parties have to be attributed in the calculation of the 30 per cent threshold (eg, voting rights of a subsidiary, bidder and third party are 'acting in concert'). In the event that two or more parties acquire control on the basis of the aforementioned attribution, the obligation to submit a mandatory offer generally applies to all acquirers.

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Exit strategies

What are the key limitations on the ability of a private equity firm to sell its stake in a portfolio company or conduct an IPO of a portfolio company? In connection with a sale of a portfolio company, how do private equity firms typically address any post-closing recourse for the benefit of a strategic or private equity acquirer?

There are three key limitations on the ability of a private equity firm to sell its stake in a portfolio company in an IPO:

- institutional investors must be convinced of the business case of the portfolio company;
- the portfolio company must be 'IPO-ready', which means that the governance of the portfolio company must comply with the provisions for listed companies. In this context, portfolio companies that are organised as limited liability companies need to be converted either to a Societas Europaea (SE), a stock corporation or a limited partnership of shares prior to the IPO; and
- market environment.

Key limitations for a trade sale are mostly price expectations of the seller and the lack of willingness of the seller to give warranties and indemnities to the buyer. The ongoing pandemic in 2021 extended the limitations for trade sales. Buyers have been acting more cautiously and have questioned the sustainability of business cases and future profits. Owing to the limited number of targets in the German market and the continuously high price levels owing to private equity firms having significant funds to spare during 2021, the price expectations of the seller have not often been a deal-breaker. Potential liabilities for representations and for tax indemnities are regularly transferred to warranty and indemnity (W&I) insurance. Private equity sellers very often expect an acquirer to enter into W&I insurance. In 2021, escrows were very rare.

2021 has still been a seller-friendly market environment. Therefore, some target companies came onto the market that would probably not have been offered in a less seller-friendly environment. We saw a significant increase in the deal flow after the lockdown in spring 2020, which continued during the entire year of 2021. Significant differences in the deal flow can be observed in the market environments still suffering from the pandemic, such as the travel, hotel and gastronomy sectors. However, it also remained extremely difficult to sell companies in the retail or fashion sectors, whereas the market environment in the technology and medical fields continued to prosper as such fields are less susceptible to cyclical fluctuations.

Law stated - 25 January 2022

Portfolio company IPOs

What governance rights and other shareholders' rights and restrictions typically survive an IPO? What types of lock-up restrictions typically apply in connection with an IPO? What are common methods for private equity sponsors to dispose of their stock in a portfolio company following its IPO?

After an IPO, only the statutory governance rights survive. A shareholders' agreement is usually terminated upon the IPO, which constitutes an exit of the private equity investor, although it could remain as a shareholder of the listed company. Under German statutory law, it is to some extent possible, but rather unusual, to agree on rights to appoint

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board members for single shareholders in the articles of association of the listed company.

Lock-up periods usually have a duration of up to 12 months for private equity investors, but are sometimes longer when it comes to management. Management advisers regularly try to agree on a provision in the shareholders' agreement that in the case of an IPO, the lock-up period for the management team will not be longer than the lock-up period of the private equity investor. However, the proposal for the duration of the lock-up period is finally at the discretion of the underwriting banks.

Usually, in an IPO, only a small portion of the shares of the existing shareholders are sold. Private equity investors sell packages of shares after the termination of the lock-up period and in predefined time periods.

Law stated - 25 January 2022

Target companies and industries

What types of companies or industries have typically been the targets of going-private transactions? Has there been any change in industry focus in recent years? Do industry-specific regulatory schemes limit the potential targets of private equity firms?

Private equity transactions occur across almost all industries. The yearly number of delistings owing to going-private transactions of private equity funds has increased in recent years. In 2021, certain industries lost their potential for transactions (eg, the automotive industry), whereas others remained constantly in demand. Generally speaking, companies with stable cash flow and growth potential are suitable for going private. In addition, there should not be a high level of indebtedness to allow further leverage. No significant free float is helpful in quickly building a strong equity position. Ideally, there are entrepreneurs or founders holding a large stake in a company who want to strengthen it with the help of a stock market withdrawal. However, like any market, private equity is cyclical, and the market may enter into the phase of post-pandemic future. As a result, borrowing rates may rise, and the debt strategy behind many private equity acquisitions won't remain as attractive.

With respect to specific regulatory schemes limiting the potential targets of private equity firms, investments in critical infrastructure, such as the arms industry, may be monitored by the Federal Ministry for Economic Affairs and Climate Action.

Law stated - 25 January 2022

SPECIAL ISSUES

Cross-border transactions

What are the issues unique to structuring and financing a cross-border going-private or other private equity transaction?

With respect to financing a cross border transaction, when a cash offer is made in the context of a cross-border going-private transaction, an independent financial services institution (eg, an investment bank) needs to confirm the availability of sufficient funds of the bidder. The financial services institution may be held liable if the bidder is then unable to pay for the respective shares. However, this does not constitute a difference from mandatory public takeovers.

Germany is an open economy; foreign investments are, in general, permissible and welcome. However, foreign investments in target companies active in certain sectors may be reviewed on a case-by-case basis by the Federal Ministry for Economic Affairs and Climate Action (BMWi). The Foreign Trade Act and the relevant ordinance provide for a sector-specific review mechanism, mainly concerning the military and defence as well as critical infrastructure sector,

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and for a cross-sectoral review concerning acquisitions of companies in other sectors, but only by investors from outside the European Union or the European Free Trade Association, under which the BMWi may prohibit direct or indirect acquisitions of at least 20 or 10 per cent of the voting rights (depending on the sectors) in a German target or impose obligations if it finds that the acquisition endangers public order or security in Germany.

Since July 2017, acquisitions of German targets active in specific areas such as critical infrastructure and development of industry-specific software for the operation of critical infrastructure must be notified to the BMWi. The sectors and areas for which a notification is required have been significantly extended by an amendment of the relevant ordinance passed in 2021. Apart from that, the BMWi acts on application for the issuance of a certificate of non-objection or on its own initiative in the cross-sectoral review. In the sector-specific review, there is a general reporting obligation regarding relevant transactions.

Law stated - 25 January 2022

Club and group deals

What are some of the key considerations when more than one private equity firm, or one or more private equity firms and a strategic partner or other equity co-investor is participating in a deal?

In club or group deals, the mutual rights and obligations should be determined as early as possible. Typically, the sale of a target company is subject to a formal structured auction process. To align the interests of the acquirers during the auction process, the acquirers should enter into a bidding consortium agreement to govern the obligations and the behaviour of the parties during the process. This agreement typically contains provisions with regard to the later acquisition and the operation of the target company and is substituted by the shareholders agreement, which follows after the closing of the transaction. Provisions with regard to deadlock situations should especially be provided for. With respect to the joint acquisition of at least 30 per cent of the voting rights in public listed companies ('acting in concert'), the Takeover Act may lead to the obligation to submit a mandatory takeover offer towards the other shareholders. Bidding consortium agreements have to consider the 'acting in concert' rule and ensure that only one takeover offer by the consortium becomes mandatory. Moreover, agreements between bidders in an ongoing auction process must be viewed critically under antitrust law. In particular, if such agreements are intended to influence the purchase price. An agreement under which one bidder withdraws from the auction process but in return is to receive a share in the target company from the other (successful) bidder after completion of the transaction may be illegal under antitrust law.

Law stated - 25 January 2022

Issues related to certainty of closing

What are the key issues that arise between a seller and a private equity acquirer related to certainty of closing? How are these issues typically resolved?

In 2021 the market remained seller-friendly for the offered targets. Therefore, private equity acquirers, like all other acquirers, had to accept that closing usually only depended on antitrust clearance as the sole closing condition. It was only possible to obtain other closing conditions in the case of deal-specific issues.

However, in 2021, a further amendment of the Foreign Trade Act (AWV) came into force. This has implications for mergers and acquisitions practice, as inter alia the sectors subject to notification requirements were expanded and thresholds for notification requirements when increasing existing shareholdings were implemented. Acquisitions subject to notification requirements are subject to an execution prohibition. Such transactions may only be executed after clearance by the Federal Ministry for Economic Affairs and Climate Action. Otherwise, there is a risk of the

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transaction becoming ineffective and even of criminal penalties and fines. It remains to be seen whether such clearance by the Federal Ministry for Economic Affairs and Climate Action will become established as a common closing condition.

Moreover, private equity acquirers were generally not able to successfully negotiate material adverse change clauses or other termination rights, but rather had to accept break fees and ‘hell-or-high-water’ obligations.

Law stated - 25 January 2022

UPDATE AND TRENDS

Key developments of the past year

Have there been any recent developments or interesting trends relating to private equity transactions in your jurisdiction in the past year?

No updates at this time.

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Jurisdictions

Jurisdiction	Firm
Australia	Ashurst LLP
Austria	Schindler Attorneys
British Virgin Islands	Appleby
Cayman Islands	Stuarts Walker Hersant Humphries
France	White & Case LLP
Germany	POELLATH
India	Khaitan & Co
Japan	Nishimura & Asahi
Mexico	Deloitte Legal
Nigeria	Streamsowers & Köhn
Russia	Dechert LLP
South Korea	Bae, Kim & Lee LLC
Spain	Cases & Lacambra
Switzerland	Niederer Kraft Frey
Thailand	Nishimura & Asahi
Turkey	Turunç
United Kingdom	Simpson Thacher & Bartlett LLP
USA	Simpson Thacher & Bartlett LLP

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