

Private Equity Transactions

in Germany

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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?

Private equity investors still aim to acquire majority stakes. Given the cash available in private equity funds and the lack of target companies, private equity investors are nevertheless more and more willing to acquire minority interests as well. Whether they do so depends either on if they can increase their interest in the target during the holding period or on specific strategic ideas.

Leveraged buyout transactions dominate the private equity market in Germany. However, we have seen an increasing number of transactions in which private equity acquirers fully fund their investments with equity.

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.

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 February 2017, and with reporting and disclosure requirements on sensitive information that private equity investors typically do not want to share publicly.

To preserve maximum flexibility, as a result, private equity sponsors typically aim for acquiring or transforming the target company into a limited liability company. In a limited liability company more specific corporate governance 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, only for an exit through an IPO do private equity sponsors accept the stricter governance rules that apply to the target company after its transformation into a stock corporation.

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 on 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 in the due diligence process to the potential buyers of the target. The board of directors must also consider if 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 takeover, 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 each decision of the board of directors is supported by a resolution of the supervisory board. The management board is allowed to take pre-bid defensive measures as well as certain post-bid defensive measures in accordance with the 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.

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 (WpHG). 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 stock corporation are acquired, the acquired company must be notified. The same applies in case of a shortfall of these thresholds. In the case of a failure of 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 October 2017, there have been new filing requirements for acquirers of shares pursuant to 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)). Exemptions apply for listed companies owing to the equivalent filing requirements pursuant to the WpHG and such entities for which the relevant data is available from other (electronic) registers. Violation of the filing obligation is punishable by a fine.

According to the Capital Investment Act (KAGB) disclosure requirements with respect to M&A transactions in which the management of alternative funds (AIFM) are involved 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 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 with respect to the voting rights and when control was acquired, 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

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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 EU or EFTA (see question 18).

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.

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 M&A advisers.

The acquisition of private companies is usually organised in auction processes coordinated by M&A advisers of the seller. 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 starts 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. Besides the negotiation between the seller and the bidder, the bidder typically is 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 when 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 rights, as defined by the German 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 has been obtained or an announcement of an offer has been 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 (for the consequences of having minority shareholders with respect to corporate governance requirements, see question 2)), 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 (see question 6).

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) stock corporation'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 and reviewed in court by the shareholders. However, this right for each individual shareholder does not prevent the completion of the transaction itself per se, as it causes only a review of the compensation. This may be different when a bidder makes an offer under 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 a 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 shareholder(s) 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).

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 aspects, which are regularly included in purchase agreements, if private equity acquirers are involved.

For example, private equity investors are as sellers reluctant to provide operational representations and warranties.

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Therefore, private equity sellers regularly demand the purchaser to take out W&I insurance to limit possible liability under the sale and purchase agreement. Private equity acquirers often ask for special warranties with regard to environment, social 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. Therefore, private equity acquirers usually enter into an equity commitment letter in favour of the special purpose vehicle.

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 arising from the listing of a 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 or by a trust company via a trusteeship. In smaller deals the managers occasionally hold their shares directly. 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.

Generally, a private equity acquirer should contact the management of the target company as soon 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 also offer the possibility to convince the management team of the private equity fund. This can be a relevant advantage in an auction process.

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 target company 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 tax EBITDA. The limitation does not apply if the tax 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 applies typically to private equity participations, are in total not deductible.

Furthermore, if the target company owns real estate, the indirect or direct acquisition of at least 95 per cent of the shares of the company may cause real estate transfer tax between 3.5 and 6.5 per cent, whereby the tax calculation base is the partial value of the real estate.

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 financing instruments to achieve higher margins. In larger transactions high yield bonds can be seen, but this form of 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.

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 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.

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 US. 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 law, such as the prohibition for shareholders of 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 (InsO) to substantiate a contest. The InsO 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.

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 GmbH and in the general meeting of an AG, whereby solely the articles of association of an AG may provide for a lower majority requirement (a simple majority).

Beside these statutory minority shareholders' protection rights, a private equity firm, as minority investor, will ensure further minority rights in a shareholders' agreement with private equity co-investors or other shareholders. These are 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, usually by triggering an exit for all shareholders.

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 (see questions 4 and 18), there are certain limitations and obligations for private equity firms in larger transactions that fall under AIF regulations (see question 4) 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, pursuant to the Takeover Act, obliged to submit a mandatory public offer to the remaining shareholders of the target to acquire their shares. 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.

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 GmbHs need to be converted either to an SE, an AG or to a KGaA 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. Owing to the limited number of targets in the German market and the high price levels during 2018, the price expectations of the seller have not mostly been a deal-breaker. Potential liabilities for representations and for tax indemnities are regularly transferred to a W&I insurance. Private equity sellers very often expect that an acquirer enter into W&I-insurance. In 2018, escrows were very rare.

In the fourth quarter of 2018 we saw a slacking-off of the seller-friendly market environment, with a still constant deal flow at a very high level.

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 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 for the management team will be 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.

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 increased during the past year, but is still too low to identify sector-specific trends. 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. It is also helpful if no significant free float makes it difficult to build 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. 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 of Economics and Technology.

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

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investments in target companies active in certain sectors may be reviewed on a case-by-case basis by the Federal Ministry of Economics and Energy (BMWi). The Foreign Trade Act and the relevant ordinance provide for a sector-specific review mechanism, mainly concerning the military and defence sector, and for a cross-sectoral review concerning acquisitions of companies in other sectors, but only by investors from outside the EU or EFTA, under which the BMWi may prohibit direct or indirect acquisitions of at least 25 per cent of the voting rights 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. 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.

In December 2018, the Federal Cabinet decided to lower the threshold for the review of the acquisition of defence and security-related infrastructure and companies to 10 per cent of the voting rights. In all other matters, the threshold of 25 per cent remains unchanged.

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. In order 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 Securities Acquisition and 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.

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 2018 the market was extremely seller-friendly. 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.

Private equity acquirers were therefore 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.

UPDATE AND TRENDS

Recent developments

Updates and trends

On 20 December 2018, the German federal government enacted a threshold decrease for the review of certain foreign investments from the previous 25 per cent of voting rights in a German company to a 10 per cent threshold. In the context of investment review, the German Federal Ministry of Economics and Technology can review foreign investments into German companies and prohibit them in the event that public security or order are endangered. Therefore, if a foreign private equity acquirer intends to purchase a participation of at least 10 per cent in critical business infrastructures, such as the arms industry, IT security industry or media companies, such acquisition may trigger investment monitoring. The amendments entered into force on 29 December 2018.

With regard to the ninth amendment to the Act against Restraints of Competition (that became effective on 9 June 2017) the Court of the European Union confirmed in a judgment of 12 July 2018 (file number T-419/14), that private equity investors are liable for cartel infringements committed by their portfolio companies. With the verdict, the court confirmed a fine imposed by the European Commission on Goldman Sachs and Prysmian in 2014. A fund from Goldman Sachs Capital Partners had acquired Prysmian while it was already involved in a market-sharing cartel. In particular, the court confirmed co-liability of Goldman Sachs for the full period of its investment in Prysmian, although the participation was well below 50 per cent in the second half of the investment period. The ruling highlighted two issues: first, that private equity investors are in principle subject to the same liability principles as industrial groups; and second, the decision shows that the concept of 'control' is interpreted broadly and which criteria are relevant (eg, rights regarding the appointment of management). Against this background, strict governance rules imposed on the target and an antitrust due diligence prior to a company acquisition and a compliance organisation at portfolio company level after the acquisition may be advisable in order to reduce antitrust risks.