The Private Equity Review

Fourth Edition

Editor
Stephen L Ritchie

Law Business Research

The Private Equity Review

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The Private Equity Review

Fourth Edition

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EDITOR'S PREFACE

The fourth edition of *The Private Equity Review* comes on the heels of a solid but at times uneven 2014 for private equity. Deal activity and fundraising were strong in regions such as North America and Asia, but were flat to declining in Western Europe. Nevertheless, private equity continues to play an important role in global financial markets, not only in North America and Western Europe, where the industry was born, but also in developing and emerging markets in Asia, South America, the Middle East and Africa. As large global private equity powerhouses extend their reach into new markets, home-grown private equity firms, many of whose principals learned the business working for those industry leaders, have sprung up in many jurisdictions to compete using their local know-how.

As the industry continues to become more geographically diverse, private equity professionals need guidance from local practitioners about how to raise money and close deals in multiple jurisdictions. This review has been prepared with this need in mind. It contains contributions from leading private equity practitioners in 26 different countries, with observations and advice on private equity deal-making and fundraising in their respective jurisdictions.

As private equity has grown, it has also faced increasing regulatory scrutiny throughout the world. Adding to this complexity, regulation of private equity is not uniform from country to country. As a result, the following chapters also include a brief discussion of these various regulatory regimes.

While no one can predict exactly how private equity will fare in 2015, it can confidently be said that it will continue to play an important role in the global economy. Private equity by its very nature continually seeks out new, profitable investment opportunities, so its further expansion into growing emerging markets is also inevitable. It remains to be seen how local markets and policymakers respond.

I want to thank everyone who contributed their time and labour to making this fourth edition of *The Private Equity Review* possible. Each of them is a leader in his or her respective market, so I appreciate that they have used their valuable and scarce time to share their expertise.

Stephen L Ritchie
Kirkland & Ellis LLP
Chicago, Illinois
March 2015

Chapter 1

AUSTRIA

Martin Abram and Clemens Philipp Schindler[1]

I GENERAL OVERVIEW

At the time of writing, no information was available about the fundraising market in 2014. According to the Austrian Venture Capital Association, Austrian private equity and venture capital funds[2] raised only €19.8 million in 2013, which represents a decrease of 85 per cent compared with 2012. Government agencies were the main sources of funding (76.6 per cent), followed by private individuals (18.3 per cent). 2013 saw a major shift in funding sources, as banks, pension funds and insurance companies, which accounted for 47 per cent of the invested funds in 2012, did not return to the private equity and venture capital market. The Austrian market remains (as in previous years) small, with investments in 2013 reaching 0.173 per cent of GDP (well below the European average of 0.253 per cent of GDP).

The number and volume of Austrian private equity and venture capital funds continues to be well below the European average. There is no noticeable activity in the market, in particular due to the increased administrative burden on funds following the introduction of the Austrian Alternative Investment Fund Manager Act (AIFMG), which implemented the AIFM Directive.[3]

II LEGAL FRAMEWORK FOR FUNDRAISING

Since the introduction of the AIFMG, most private equity funds established in Austria will qualify as alternative investment funds (AIFs) under the AIFMG. An AIF is defined as a collective investment undertaking that raises capital from a number of investors to

1 Martin Abram and Clemens Philipp Schindler are partners at Schindler and Partners.

2 Only aggregate figures are available.

3 Directive 2011/61/EU on alternative investment fund managers.

invest it in accordance with a defined investment policy for the benefit of those investors, and that does not use the capital for a direct operational purposes. Funds pursuant to the Austrian Investment Funds Act as well as funds qualifying under the Austrian Real Estate Investment Funds Act are not captured by the AIFMG.

The formation of an AIF requires the prior approval of the Austrian Financial Market Authority (FMA) if the fund is managed by a licensed alternative investment fund manager (AIFM). If the fund is managed by a registered AIFM, it only needs to be registered with the FMA. AIFMs need to obtain a licence if they manage funds with assets of less than €100 million (where leverage is used) or less than €500 million (where no leverage is used); otherwise, only a registration is required.

In order to obtain a licence under the AIFMG, the manager must fulfil the following requirements:

a a licensed AIFM needs to have a minimum capital of €125,000 if it is an external manager of an AIF. If the AIFM is an internal manager of an AIF, the minimum capital requirement is €300,000. In addition, the AIFM needs to have sufficient equity to cover 25 per cent of its annual running costs. Increased equity requirements apply if the assets under management exceed €250 million; in any case, the maximum minimum capital is €10 million. The persons tasked with the management of the AIFM need to be sufficiently experienced, and have to pass a 'fit and proper' test of the FMA if so requested;

b the AIFM has to appoint at least two individual persons as its managers; and

c in the application to the FMA, the AIFM needs to provide information on shareholders holding qualified participations in the AIFM (i.e., shareholdings exceeding 10 per cent), on any closely related entities (i.e., a third party that holds a stake of more than 20 per cent of the AIFM or that controls the AIFM, or is controlled by the AIFM or in which the AIFM holds a stake of more than 20 per cent), its business plan, its remuneration policy, its investment strategies, a description of any competences delegated to third parties and information on the contractual basis pursuant to which it manages its AIFs.

The decision of the FMA regarding the licensing of an AIFM has to be made within three months.

i Vehicles used for private equity funds

The main vehicles used for private equity funds established in Austria are limited partnerships (LPs), typically with a corporation as the general partner, or corporations, namely limited liability companies (LLCs) and joint-stock companies (JSCs). Each of these types of entity has a separate legal personality.

LPs

Investors become limited partners in an LP. The general partner is usually an LLC that receives a fee for assuming unlimited liability. In some structures, the general partner manages the partnership; in other structures, a separate management company (usually an LLC) manages the partnership. As private equity funds in most cases fall under the AIFMG, the entity managing the fund must be a legal person licensed or registered as

an AIFM under the AIFMG. There are generally no minimum capital requirements for newly incorporated LPs.

Corporations

Investors become shareholders in an LLC or a JSC. An LLC is managed by a managing director, a JSC by a managing board. JSCs (as opposed to LLCs) are required by law to also have a supervisory board. Managing directors, as well as members of the managing board, have to be natural persons. However, as with LPs, corporations can outsource management functions to a management company. Austrian law has minimum share capital requirements for LLCs (€35,000, or €10,000 in the case of a privileged incorporation) and JSCs (€70,000).

In the past, sponsors also structured vehicles in the form of LLCs or JSCs as a medium-sized business financing company (MFG) under the Corporate Income Tax Act (KStG), as this gave rise to several tax benefits. MFGs had to fulfil certain requirements, such as higher capitalisation, participation of public bodies and certain investment restrictions. As those tax benefits no longer apply for vehicles founded after 2012, and will cease to apply in respect of participations held by existing MFGs (founded before 2012) by the end of 2015 (in special circumstances, by the end of 2018), the importance of the MFG has decreased significantly.

ii Key legal terms

In addition to terms imposed by mandatory provisions of Austrian law, in particular the investor protection provisions of the AIFMG for private equity funds classified as AIFs, the key terms of the relationship between the investor and the fund are governed by the partnership agreement (for LPs) or the articles of association and shareholders' agreements (for LLCs and JSCs). Terms of a private equity fund typically subject to negotiation include:

- *a* investment restrictions, such as target size, concentration limits, geographic limitations, diversification of industries, limits on borrowing and related-party transaction restrictions;
- *b* limitations on the fund's size and the investors' capital commitments;
- *c* investment period;
- *d* key-man provisions;
- *e* provisions permitting the removal of the manager by a qualified majority of investors;
- *f* remuneration of the manager (i.e., management fee, investment-related fees and carried interest);
- *g* reinvestments; and
- *h* exclusivity.

iii Disclosure of information

In recent years, Austria has seen an increasing number of court proceedings by private investors against managers and promoters of funds to recover losses suffered during the financial crises. These proceedings highlight the importance of full disclosure to investors at the time they invest in a fund.

Managers of funds need to ensure that all documents given to investors, in particular the offering documentation and all advertising material, disclose all facts and circumstances relevant to prospective investors fully and correctly. Additionally, special care should be taken that any opinions and plans disclosed to investors are reasonable, and based on verifiable facts. Special care also needs to be taken to ensure that the wording of the documents is not too complicated or technical; otherwise there is a risk that this could be seen as insufficient disclosure. Austrian courts do, by and large, take into account the types of investors to which such offering documentation is addressed, and may take a less restrictive position in cases where an offer is solely addressed to institutional investors (as opposed to offers addressed to retail investors).

In the case of insufficient disclosure, managers are faced primarily with damage or rescission claims, or both by investors; additionally, regulatory sanctions and – in extreme cases – criminal sanctions may apply.

The key items for disclosure vary depending on whether the offer of the fund interest falls under the scope of the Austrian Capital Markets Act (in which case a prospectus conforming to the EU prospectus regime has to be published). Typically, the main items for disclosure are:

a investment strategy;
b market overview and regulatory environment;
c key terms of the investment (see above);
d risk factors;
e track record of the manager and its executives; and
f tax matters.

If the offer of interests in a private equity fund falls under the scope of the Austrian Capital Markets Act (and no private placement exemption applies), the issuer has to prepare a prospectus, which complies with the EU prospectus regime. In this case, additional disclosure requirements apply.

iv Solicitation

The method of solicitation is mainly influenced by regulatory constraints. Most commonly, solicitation is made by way of an information or offering memorandum. Potential key investors are typically contacted at an early stage to gauge their initial interest. Unless there are regulatory constraints (such as in the case of public offers falling under the scope of the Austrian Capital Markets Act), investors are invited to follow-up meetings or given the opportunity for a limited due diligence. Depending on the size of the fundraising, managers may also appoint third-party promoters to assist in identifying potential investors; also in addition, outside counsel is retained to prepare the documentation for the fundraising.

Limitations on solicitation

Offers and sales of interests in private equity funds formed in Austria are subject to the following selling restrictions, which depend on the category of the private equity fund.

For AIFs managed by a licensed AIFM:

a interests in the fund may only be offered or sold after the AIF is approved by the FMA; and

b interests in the fund may be offered or sold to private investors, if the prerequisites of Sections 48 and 49 AIFMG are met, except if the fund is registered as a European venture capital fund (EuVECA) (see below); in this case, it may be offered to private investors subject to certain restrictions (in particular, a minimum investment commitment of €100,000 and a written acknowledgment of the risks associated with the investment by the private investor).

For AIFs managed by a registered AIFM:

a interests in the fund may only be offered after the AIF was notified to the FMA; and

b interests in the fund may not be offered or sold to private investors, except if the fund is registered as an EuVECA (see below); in this case, it may be offered to private investors subject to certain restrictions (in particular, a minimum investment commitment of €100,000 and a written acknowledgment of the risks associated with the investment by the private investor).

For private equity funds falling outside the AIFMG:

a any public offer of interests in private equity funds falling outside the AIFMG requires the publication or approval of a prospectus by the FMA, or both, unless a private placement exemption applies;

b the private placement exemption applies, in particular, for offers to qualified investors only; offers with a minimum investment amount of €100,000; and offers to less than 150 investors; and

c even if the private placement exemption applies, the intended offer has to be notified to the issue register maintained by Oesterreichische Kontrollbank AG.

v EuVECA Regulation[4]

The EuVECA Regulation was introduced to create a new pan-European designation for small AIFMs, the EuVECA. Austrian-based AIFMs may register an AIF as a EuVECA provided that they comply with the EuVECA Regulation and have supplied certain information with regard to themselves and the relevant AIF to the FMA. The main advantage the AIFM gains by doing so is the option to market the relevant AIF throughout the EU under the EuVECA designation to certain categories of investors defined in the EuVECA Regulation under an EU-wide passporting regime. Passporting allows a firm authorised under an EU single market directive to market the designated fund to certain qualified investors in another EU Member State, on the basis of its home state authorisation.

The EuVECA Regulation is not compulsory; if an AIFM does not want to use the EuVECA designation, then it does not have to comply with the EuVECA Regulation for a particular fund (or at all). If the AIFM chooses not to use the EuVECA designation, national laws and EU regulations apply, such as national private placement regimes.

4 Regulation (EU) 345/2013 on European venture capital funds.

vi Fiduciary duties to the investors

Typically, the scope of the sponsor's fiduciary duties is determined by the AIFMG (which most private equity funds fall under), the constitutional documents of the fund vehicle (supplemented by pertinent rules of law) and other contractual arrangements (if any).

Under the AIFMG, the manager has, *inter alia*, to act in the best interests of the investors in such AIF (as well as of the AIF itself) and the integrity of the market. The manager has to introduce appropriate procedures to deal with conflicts of interest, to treat the investors in an AIF fairly, and to use the required diligence in the performance of his or her duties.

Managers of Austrian private equity funds are most frequently general partners of an LP or fulfil their function based on management agreements with the fund vehicle. Thus, the scope of the managers' duties and the extent of their liability in relation to the investors (and the fund vehicle) derive from the partnership agreement (supplemented by the mandatory provisions of the Commercial Code) or, as the case may be, the management agreement.

Unless the private equity fund is an AIF, it is possible to limit the liability of the sponsor in relation to the investors or, respectively, the fund vehicle by contractual provisions (e.g., excluding the liability for 'ordinary negligence'). However, such contractual provision would still be subject to judicial review.

III REGULATORY DEVELOPMENTS

Private equity funds established as AIFs and their managers are subject to the ongoing supervision of the FMA. The FMA has a wide range of inspection and audit rights with respect to both the AIFM and the respective AIF.

Austrian law distinguishes between AIFMs, which require licensing by the FMA, and AIFMs, which only have to register with the FMA. Licensed AIFMs do not need any additional licences for their management activities for the fund. Registered AIFMs may require a business permit for asset managers.

As mentioned above, investors holding qualified participations in the AIFM (i.e., shareholdings exceeding 10 per cent) need to be disclosed to the FMA, but only by licensed AIFMs.

Private equity funds established as AIFs need to be registered with the FMA. Private equity funds established as AIFs and managed by a licensed AIFM also require approval by the FMA. Austrian AIFs are also listed in an informal register maintained by the FMA.

Private equity funds not established as AIFs require no special registration, except for the registration with the Companies Register upon incorporation.

If the sponsor also acts as the manager of a fund established as an AIF, it has to be registered or, as the case may be, licensed with the FMA. In addition, if the sponsor holds a qualified participation in the fund, this fact has to be disclosed to the FMA.

Otherwise, no specific licence requirements exist for the sponsors of a fund.

i Taxation

Taxation of the fund

As mentioned above, the most common private equity fund vehicle in Austria is a partnership. Different from corporations, Austrian partnerships are typically viewed as transparent for corporate tax purposes, provided that the partnership's sole activity qualifies as asset management for tax purposes, and it is not deemed to operate a business or commercial operation.

Any income derived by the partnership is allocated to its investors and taxed at their level in accordance with the rules of the tax regime applicable to the respective investor.

If the partnership is structured with no individual (but only a corporation) as general partner, as is usually the case, equity contributions will generally be subject to capital duty at a rate of 1 per cent. The same is true for fund vehicles structured as corporations. Note, however, that according to a law passed in 2014, capital duty will no longer be levied as of 1 January 2016. Another area to consider is stamp duties, in particular in relation to guarantees that the formation documentation may entail. In this context, it should be noted that surety agreements (including any form of assumption of a debt as joint debtor) are subject to stamp duty at a rate of 1 per cent of the secured amount provided that the surety is of an accessory nature, which means that the guarantor may avail itself not only of all defences that it personally has against the creditor, but also of all defences that the debtors of the secured debt have against the creditors. If the guarantee, however, is of an abstract nature, meaning that the guarantor has to pay upon first demand and has recourse only to those defences that arise from the guarantee itself, then such transaction is not subject to stamp duty. Therefore, guarantee wordings explicitly stating that a specific guarantee is intended as an abstract are commonly used.

Taxation of investors

Domestic individual investors are taxed as follows: capital gains are subject to a preferred tax rate of 25 per cent; and dividends are subject to withholding tax at a rate of 25 per cent.

Domestic corporate investors are taxed as follows: capital gains are taxed at a rate of 25 per cent if they relate to an Austrian-resident portfolio company, and may be tax-exempt if they relate to a foreign-resident portfolio company in which a minimum shareholding of 10 per cent is (indirectly) held for an uninterrupted period of at least one year (Section 10, KStG); and dividends are tax-exempt if they relate to an Austrian-resident portfolio company or an EU-resident portfolio company, and may be tax-exempt if they relate to another foreign portfolio company (Section 10, KStG).

Foreign individual investors are taxed as follows: capital gains are only taxable (at a rate of 25 per cent) if the percentage of the investor's (weighted) shareholding in the Austrian portfolio company (through the partnership) is at least 1 per cent during the past five years. Note that double tax treaties usually restrict Austria's right to tax such capital gains (Article 13, paragraph 5 of the OECD Model Tax Convention on Income and on Capital (MTC)); and dividends are subject to withholding tax at a rate of 25 per cent (subject to a reduction under applicable double tax treaties).

Foreign corporate investors are taxed as follows: capital gains are only taxable (at a rate of 25 per cent) if the percentage of the investor's (weighted) shareholding in the Austrian portfolio company (through the partnership) is at least 1 per cent during the past five years. Double tax treaties usually restrict Austria's right to tax such capital gains (Article 13, paragraph 5, MTC); and dividends are subject to withholding tax at a rate of 25 per cent in cases where the exemption for foreign investors that are corporations resident in an EU Member State is not applicable (but will usually be subject to a reduction under applicable double tax treaties).

Taxation of carried interest

'Carried interest', which is defined as a compensation of a partner of an asset management partnership received because of outstanding contributions to the successful management of the investments, is included in the investment income according to the Ministry of Finance.[5] Therefore, the investment income received by an individual subject to unlimited taxation in Austria is taxable in Austria with the special tax rate of 25 per cent. Despite this administrative guideline, a case-by-case analysis is recommended, as the line between self-employed and employee income and investment income is rather unclear.

The management fees received by a partner of an asset management partnership are not subject to VAT. According to the Austrian tax authorities, the managing partner of a partnership is not an entrepreneur; his or her services are supplied in the exercise of a corporate function, and not as a result of an exchange of services. If the fund vehicle is a corporation, however, the fees of a managing partner will usually be subject to VAT, unless the manager is employed by the corporation.

IV OUTLOOK

The outlook for Austrian private equity funds remains unchanged, and it is expected that the number and volume of funds will also not change in the near future.

5 EAS 3280 as of 14 May 2012, EAS 2698 as of 6 February 2006 and BMF 15 December 2008 (BMF 010221/3364-IV/4/2008).

Chapter 1

AUSTRIA

Florian Philipp Cvak and Clemens Philipp Schindler[1]

I GENERAL OVERVIEW

i Deal activity

At the beginning of 2014, the overall outlook for private equity in Austria was positive, in particular after a strong fourth quarter 2013. Most of the funds active in the market expected deal activity to go up, and financing conditions for buyouts to broadly stay the same or to improve.

Overall, expectations regarding buyouts were well justified. While no official 2014 statistics are available yet, the total value of private equity buyouts in 2014 should have increased, although much of this marked increase can be attributed to three larger transactions: the acquisition of Constantia Flexibles Group GmbH by Wendel SA, the acquisition of a stake in CA Immobilien Anlagen AG by O1 Group Limited, and the acquisition of the SEE network of former Hypo Alpe-Adria-Bank International by Advent International and the European Bank for Reconstruction and Development (EBRD) (see Section III, *infra*).

Apart from these three large buyout transactions, there were a number of auctions for Austrian-based small to mid-cap targets that created significant interest mainly among German-based funds and international funds run out of Germany, which sometimes faced competition from Austrian-based family offices, investment holdings and foundations that, while not formally organised as funds, substantially pursue similar investment objectives. Unfortunately, several of these auctions did not lead to signing, which was sometimes due to the gap between the offers received and the pricing expectations of the sellers, and in other cases due to the relative complexity of the transaction compared with its size.

1 Clemens Philipp Schindler and Florian Philipp Cvak are partners at Schindler and Partners.

Another trend that continued from 2013 were bank-driven restructurings that resulted in the auctioning off of non-core or non-performing assets. In most cases, these restructurings related to the retail sector. One example was the do-it-yourself chain Baumax, with stores throughout the CEE region. This is also a quite interesting deal source nowadays for funds that, due to their special are of expertise or financial strength, can convince sellers or their financing banks, or both, to negotiate a transaction outside an auction process. What is not yet common are bridge financings by funds with the option to eventually convert the debt into equity, thus using the financing as an in-route into companies.

2014 saw a number of sizeable non-performing loan auctions that attracted significant interest from international specialist funds. It is to be expected that this trend, which has been ongoing for some years, will continue in 2015. Portfolios that are being auctioned range from consumer loans to corporate loans. In the corporate environment, loans are sometimes offered by only one specific borrower, but usually attract less interest than diversified portfolios.

There were a number of growth capital transactions, most of which concerned investments of less than €5 million. The majority of these deals related to funding rounds of start-up companies, which have substantially increased in number over the past couple of years, mainly due to government-funded start-up programmes and a couple of very active angel investors that recently posted some impressive exits. Examples of recent exits include Runtastic, which was partially sold to the German company Axel Springer Verlag, and YOUSURE Tarifvergleich GmbH, which was partially sold to Bermuda-based Mountains Insurance Group. Another signal of the attractiveness of this segment was the establishment of the European Angels Fund Austria, established by the European Investment Fund and Austria Wirtschaftsservice GmbH, the government promotional bank financing companies based in Austria. The Fund aims to provide equity to business angels and other non-institutional investors to finance innovative companies in the form of co-investments.[2]

ii Operation of the market

In buyout transactions, the private equity firm often involves future management regarding the due diligence process and the financial modelling. Typically, the management is offered the opportunity (and is sometimes even required) to acquire an interest in the target to ensure the management's commitment. Senior management is sometimes also given the opportunity to invest in the same instruments ('institutional strip') acquired by the private equity firm to ensure that senior management's interests are fully aligned.

In some cases, the incentive provides for a ratchet mechanism entitling the management to an enhanced return once the return of the private equity firm exceeds a certain threshold. The detailed structuring of incentive packages is dependent on the tax treatment of the benefits in the relevant jurisdictions of their residence. For example, the management will have a strong interest in ensuring that any gains in relation to the interests acquired are taxed as capital gains (and not as income). Since the tax treatment of incentive programmes is often somewhat unclear, it is advisable to try to obtain a tax ruling on the related tax issues before deciding on a certain structure.

2 www.eif.org/what_we_do/equity/eaf/Austria.htm.

The most common form is to offer the management actual shares (as opposed to phantom stock, option plans or bonus regimes) in the target. In typical equity structures, the management is asked to purchase shares at fair market value (the usual investment is up to one year's salary). Such structures – as opposed to structures where management can purchase shares at a discount – avoid taxation of the management at the time they acquire the shares; only capital gains realised upon an exit will be subject to taxation. If the investor provides financing to the management, tax authorities may be more inclined to question whether economic ownership (which for tax purposes is the relevant criterion) has transferred to the respective individual.

The shares held by the management are usually pooled (e.g., through a partnership) so that the investor technically has only one co-investor, and are restricted. Such restrictions will typically include a drag-along right of the private equity firm upon an exit and compulsory transfer provisions if the employment with the target group terminates. The consideration due in the case of such transfer will typically depend on the reason for termination ('good' or 'bad' leaver provisions).

Auction processes are more common. A standard auction process will typically be organised by an investment bank (or an M&A adviser). As a first step, the investment bank will propose a short list of potential bidders and discuss that short list with its clients. The investment bank will then invite the selected bidders to submit an indicative bid on the basis of an information package including limited commercial, financial and basic legal information about the target company. Following evaluation of the indicative bids, the investment bank will invite the most promising bidders to conduct phase one due diligence, for a period of typically two to six weeks, and to submit a binding bid (usually together with a mark-up to a sale and purchase agreement distributed in the middle of the phase one due diligence) by a separate process letter. Following evaluation of the binding bids, the private equity firm will engage in negotiations with two to three bidders, which may then be granted access to the phase two due diligence material and red files (if any). The time required for the entire process varies significantly depending on the appetite for the target and the number of bidders involved. It can range from as little as two to three months up to six months or more.

II LEGAL FRAMEWORK

i Acquisition of control and minority interests

A typical acquisition structure for an Austrian private equity transaction involves a set of holding companies (HoldCos) incorporated in Luxembourg, the Netherlands or other taxfavourable jurisdictions, and an Austrian acquisition vehicle (BidCo), which enters into the purchase agreement and ultimately acquires the shares.[3] The funds will typically try to leverage the transaction. Where junior debt (e.g., mezzanine lenders) is applied, senior lenders will often require them to lend to a level higher than the senior lenders

3 Austrian tax law also provides for a goodwill amortisation in the case of share deals. As such regime is not available for acquisitions made after 28 February 2014, this may lead to an increased number of foreign BidCos.

to achieve not only contractual subordination (which is achieved by entering into an intercreditor agreement) but also structural subordination. The remaining purchase price is usually financed by the fund through a combination of equity and institutional debt. The amount of institutional debt is determined by thin cap rules. While statutory law does not provide for any guidance, debt-to-equity ratios of 3:1 to 4:1 are generally perceived to be in line with the current practice of the Austrian tax authorities. The equity is usually channelled down to Austria by way of indirect grandparent capital contributions to avoid capital tax (which would be triggered in the case of a direct parent capital contribution). Capital tax on direct capital contributions will be abolished, effective as of 1 January 2016, which means simpler deal structures such as interim HoldCos previously needed for capital tax reasons will no longer be required.

On or shortly after completion of the share purchase, the target company is usually asked to accede to the financing documents on an exclusive lender basis (to avoid structural subordination of the financing banks to incumbent borrowers), and to grant guarantees and security interests securing the acquisition debt as well as refinancing and other target company debt. To the extent such guarantees and security interests secure repayment of the acquisition debt, they are of little commercial value as they are only valid to the extent:

a that the risk of default of the shareholder and the risk of default of the subsidiary (in cases where the security interest is enforced or the guarantee called) are acceptable, and that the granting of the security interest or guarantee will not put the subsidiary at risk considering the risk of default of the shareholder and the likelihood of recovery based on recourse from the shareholder in cases where the security interest is enforced or the guarantee called; and

b the target company receives adequate consideration, which can either be a fee (in which case it should include a margin on top of the fee charged by banks) or an equivalent corporate benefit (e.g., access to financing that it would otherwise not be able to obtain at such terms). To preserve the validity of the guarantees and security interests at least in part and avoid management (and supervisory) board liability, 'limitation language' is typically included in the financing documents that limits the obligations of Austrian obligors to an amount and under terms compliant with the Austrian capital maintenance rules.

At the same time, the private equity fund will seek to implement a tax offset structure, which is aimed at offsetting interest expense at the BidCo level with profit generated at the target company level. In principle, there are two methods for achieving this. The first method is to establish a tax group between the BidCo and the target company. In such tax group, the fiscal result of the BidCo and the target is consolidated at BidCo level, and thus the fiscal results of the BidCo and the target are offset. If the aggregated fiscal result of the BidCo and the target is negative, the loss can be carried forward by the BidCo to future periods. The formation of such tax group requires a tax allocation agreement and an application to the tax office. The required minimum period of a tax group is fulfilled when three full fiscal years have expired. If the tax group is collapsed prior to the lapse of the three-year period, the group members are retroactively taxed on a standalone basis. A second method, which is sometimes discussed but rarely implemented because of the significant implementation risk it involves, is an upstream merger of the target company

into the BidCo. Based on past decisions of the Austrian Supreme Court, it is pretty clear that where the BidCo carries the acquisition debt for the purchase of the shares of the target company, a down-stream merger of the BidCo into the target company will not be registered. In certain exceptional cases, an upstream merger of the target company into the BidCo may, however, be feasible. The result of such upstream merger would be that the shares in the target company pass to the BidCo parent, interest expense on the acquisition debt can be offset against profit, and guarantees and security interests granted by the merged entity (holding the cash-generating assets) are not subject to the limitations under the Austrian capital maintenance rules (see above) and thus will be of greater commercial value. In particular, the last point is often of great interest to the financing banks, which is why this route is sometimes explored when a particular case supports such arguments.

In a buyout transaction, the key legal documents include the acquisition documents, that is, one or more share purchase agreements with the seller and the financing documents (including agreements governing equity contributions and institutional debt coming from the fund), a senior (and mezzanine) facility agreement governing the debt financing coming from the banks, security documents and an intercreditor agreement governing priority among the various layers of debt). In addition, where the fund does not acquire all of the outstanding share capital, there will have to be governance documents in place, including a shareholders' agreement, amended articles of association, and by-laws for the management board and supervisory board (if any). The main areas of concern in the control documents are the fund's right to appoint sponsor representatives to the supervisory board (or an observer to the supervisory board, or both), sponsor representative liability (see subsection ii, *infra*), a list of matters requiring the consent of the fund or the sponsor representative (which should be tailored such that there is no undue influence on the day-to-day business of the management board), anti-dilution provisions, a liquidation preference for the fund, and information and exit rights for the fund.

In most cases, the fund will also insist that at least senior management enters into a management equity incentive arrangement (see subsection ii, *infra*), and that the management and all key personnel enter into service agreements acceptable to the fund.

ii Fiduciary duties and liabilities

Duties owed by a shareholder

Austrian courts have consistently held that shareholders owe a duty of loyalty to the company and to other shareholders, requiring the shareholder to consider the interests of the company and that of other shareholders in good faith and in line with good morals. As a general matter, the scope of the duty of loyalty is more pronounced for closely held companies than for widely held companies, and differs from shareholder to shareholder depending on the ability of the relevant shareholder to cause a certain action either to be taken or not taken. A majority shareholder may, for instance, be exposed to liability for a failure to appear and vote on a matter under certain circumstances, whereas a minority shareholder will not. The duty of loyalty may require a shareholder to appear and approve a proposal of the management board where the implementation of the proposal is necessary for the survival of the company (e.g., a capital increase, a capital reduction or an asset sale in a restructuring).

A private equity fund shareholder must also consider his or her duty of loyalty at the time of exit. As a general matter, all exiting shareholders must account for the legitimate interests of the company and its shareholders when exiting their investment and prevent unnecessary harm (e.g., by excluding unpromising bidders, restricting competitors' access to information and ensuring confidentiality for all sensitive information). Accordingly, the private equity fund should ensure that a professional process in this regard is in place.

The private equity fund should also be aware that, in considering the duty of loyalty, Austrian courts have discussed concepts similar to the 'corporate opportunities doctrine' under which, in essence, whenever an opportunity is within the scope of activity of the company, a shareholder may generally not exploit such opportunity for his or her own gain.

A violation of fiduciary duties may result in claims for damages, cease and desist orders or an appeal of any shareholder vote violating such duties.

Duties owed by members of the management and supervisory boards

As a general matter, all members of the management (the board of directors in the case of a stock corporation, the chief executive officer in the case of a limited liability company) and the supervisory board (if any) of an Austrian company, including any sponsor representatives, owe to the company (not the shareholders or any other constituents) the following duties:

- *a* the duty of care, requiring members to exercise the level of care of a proper and diligent person in similar circumstances (which includes an obligation to be reasonably informed and articulate any concerns they may have);
- *b* the duty of loyalty, requiring members to act in the best interest of the corporation and its shareholders and not in their own interest;
- *c* the duty of confidentiality; and
- *d* in the case of members of the management board, a duty not to compete. Supervisory board members are not explicitly prohibited from competing with the company, but any competition will always be subject to scrutiny under the duty of loyalty.

Where a member of the management or the supervisory board is at fault, he or she is jointly and severally liable for any damages incurred by the company with all the other members at fault, unless the shareholders' assembly has approved the measure resulting in the damage. The company may waive its damage claims with an affirmative shareholder vote of 80 per cent after five years, or even before that with an affirmative vote of all shareholders. The company may also take out directors and officers liability insurance for the members of the management board, in which case the associated expense is treated as part of the remuneration of the relevant members.

A private equity fund should be aware that creditors of the company (or, where insolvency proceedings have been opened, the administrator in such proceedings) can bring damage claims on behalf of the company to the extent they cannot recover damages from the company in the following circumstances:

- *a* where such claim is based on provisions protecting the proper pay-in of share capital (including liability for unpaid capital contributions of foremen and liability for an unpermitted return of capital) or on unpermitted payments made during the insolvency of the company; or

b where the relevant member of the management or supervisory board was grossly negligent.

A waiver of company or shareholder approval of the relevant measure does not relieve from liability towards creditors (or the administrator).

Other sources of potential liability for the private equity fund involve:

a piercing the corporate veil, which is possible in the following circumstances:
- factual management by, or the exercising of control over, the management board by a shareholder (where a shareholder, while not formally appointed, factually manages or substantially controls the management board);
- undercapitalisation (only where there is an obvious imbalance between the risks of the business and the equity that is likely to result in a default damaging creditors);
- intermingling of assets (where, based on accounting records, the assets of the company cannot be separated from the assets of the shareholder); and
- shareholder action putting the company at risk (where a shareholder takes action resulting in insolvency (e.g., acceleration of loans resulting in illiquidity or termination of a necessary patent));

b liability based on a breach of provisions protecting the proper pay-in of share capital (including liability for unpaid capital contributions of foremen, liability for unpermitted returns of capital and breach of the financial assistance rules); and

c liability up to the amount secured where a shareholder has granted a guarantee or security interest securing a loan of a portfolio company in financial crisis (as defined in the Company Reorganisation Act), in which case the portfolio company can request the creditor to claim against the shareholder first (in such case, the recourse claim of the shareholder is suspended until the financial crisis is over). If the portfolio company pays the creditor, the portfolio company can request reimbursement from the shareholder.

III YEAR IN REVIEW

i Recent deal activity

There were a number of buyout transactions in 2014. The most notable by far in terms of value was the acquisition by Wendel SA of a majority stake in Constantia Flexibles Group GmbH, an Austria-based provider of packaging solutions for the human and pet food production, pharmaceuticals and beverage industries, from One Equity Partners LLC and Herbert Turnauer Foundation, an Austria-based holding company, valuing the company at €2.3 billion (equal to approximately 9x 2014 EBITDA). Leverage in that transaction amounted to approximately 5x 2014 EBITDA, which is in line with current market trends for comparable assets. For One Equity Partners LLC, it was the second attempt to exit Constantia Flexibles Group GmbH, following an IPO process in 2013 that was ultimately abandoned over unsatisfactory pricing. Private equity investors had already shown interest in the target in 2013, but One Equity Partners LLC apparently preferred to take the IPO route.

In a second notable transaction, O1 Group Limited, a Russia-based investment holding, purchased a minority stake of approximately 16.35 per cent in CA Immobilien Anlagen AG, a listed Austria-based real estate developer, from UniCredit Bank Austria AG, at a transaction value of €295 million. The transaction involved bearer shares and four registered shares that give O1 Group Limited the right to delegate a member of the supervisory board. Following completion of the transaction, O1 Group Limited launched a voluntary bid for up to 26 per cent of the outstanding shares (which is the statutory threshold of voting rights in an Austrian-listed company that must be achieved before a mandatory takeover bid to all shareholders can be launched). There was considerable interest from a limited number of financial sponsors in the transaction despite the difficult shareholder structure, which, according to the market, was due to the attractive net asset value (NAV) per share. Other Austrian-listed real estate developers show similarly attractive NAVs per share, which may mean there will be more activity in that sector. On the other hand, many such real estate developers have considerable exposure in the CEE, for which the appetite of investors continues to show signs of stalling.

The third major buyout transaction of the year involved the purchase of the SEE network of former Hypo Alpe-Adria-Bank International by Advent International and the EBRD, which was driven by a 2013 state aid decision of the EU that forced government-owned Hypo Alpe-Adria-Bank International to either sell its SEE network or wind down operations. The process was politically highly sensitive, which is why reliable public information on the transaction is rather limited. It is also interesting to note that the Austrian part of the bank was acquired by a financial investor, Indian-based Anadi Financial Holdings Pte Ltd. Prior to the financial crisis, the interest of private equity funds in Austrian financial institutions was obviously substantially higher, with the acquisition of the union bank BAWAG by Cerberus. BAWAG is one of several banks that are expected to be auctioned soon.

ii Financing

The financing environment for buyout transactions has more or less remained unchanged, and is quite different for domestic market participants (as opposed to international players), who typically seek financing from domestic banks, and international financial sponsors who are able to tap international banks (at least on large-cap deals). Leverage levels for large-cap transactions have gone up slightly in 2014 to around 5x EBITDA, and relative debt-to-equity ratios of 40 to 50 per cent. Small to mid-cap transactions are sometimes financed through equity only, or by domestic or German banks. Leverage levels and relative debt-to-equity ratios generally tend to be lower for small to mid-cap transactions than for large-cap deals.

Where leverage is employed on small and mid-cap transactions, there is usually only senior and institutional debt, as mezzanine structures tend to add another layer of complexity that is often not supported by the limited transaction size. On large-cap transactions, mezzanine financing is sometimes considered but, given the limited transaction size, is ultimately seldom employed. High yield instruments are usually only considered for post-completion refinancing, as the time and cost involved tend to be disproportionate to any gains on the pricing side.

IV REGULATORY DEVELOPMENTS

Domestic funds typically qualify as alternative investment funds (AIFs); as such, managers require a licence issued by the Austrian Financial Market Authority (FMA) under the Austrian Alternative Investment Manager Act (AIFMG). Most domestic funds qualify for the *de minimis* exception for managers of small AIFs with assets of less than €100 million (where leverage is used) or less than €5 million (where no leverage is used), and as such do not require a licence from but are only registered with the FMA. Another benefit is that they are only subject to a very limited number of regulations under the AIFMG.

Licensed AIFMs do not require any additional licences or permits for their investment activities. Registered AIFMs may require a trade permit for asset managers for their investment activities.

i Licensing processes

Licensed AIFMs

In order to obtain a licence under the AIFMG, the manager needs to fulfil certain requirements:

a a licensed AIFM must have a minimum capital of €125,000 if it is an external manager of an AIF. If the AIFM is an internal manager of an AIF, the minimum capital requirement is €300,000. In addition, the AIFM must have sufficient equity to cover 25 per cent of its annual running costs. Increased equity requirements apply if the assets under management exceed €250 million; in any case, the maximum minimum capital requirement is €10 million. The persons tasked with the management of the AIFM must be sufficiently experienced and must pass an FMA 'fit and proper' test, if requested to do so;

b the AIFM must appoint at least two individuals as its managers; and

c in the application to the FMA, the AIFM must provide information on shareholders holding qualified participations in the AIFM (i.e., shareholdings exceeding 10 per cent), on any closely related entities (i.e., a third party that holds a stake of more than 20 per cent of the AIFM or that controls the AIFM, or is controlled by the AIFM or in which the AIFM holds a stake of more than 20 per cent), its business plan, its remuneration policy, its investment strategies, a description of any competences delegated to third parties and information on the contractual basis pursuant to which it manages its AIFs.

A decision of the FMA regarding the licensing of an AIFM must be passed within three months.

Small AIFMs

As mentioned above, registered AIFMs may require a trade licence. A trade licence for asset managers requires an application to the competent trade authority. In such application, the AIFM has to prove that he or she employs a person in a management function that has the necessary qualifications to supervise the business operations of an asset manager (typically, a university education or practical experience, or both).

ii Ongoing obligations

Licensed AIFMs are subject to the disclosure requirements under the AIFMG, which require, *inter alia*, the submission of an annual report to the investors and the FMA, as well as the submission of a quarterly overview of all AIFs under management.

Under the terms of the trade licence, there are no material ongoing reporting obligations for small AIFMs (unless a person in a management function mentioned in the application leaves the company).

iii FMA consent for transactions

If an AIF intends to acquire a qualified participation in a company that is itself licensed by the FMA (i.e., banks, insurance companies, security service providers), the FMA must approve such acquisition. A qualified participation is an interest of 10 per cent or more in the capital or voting rights. This threshold increases to 20 per cent for certain types of securities services providers.

V OUTLOOK

PE-related deal activity increased in 2014. Several of the targets that came on the market were related to the banking sector, and concerned either banks themselves or the restructuring of (mostly) retail businesses forced to sell non-core or non-performing assets by banks. This trend should continue, as there are no signs of recovery in either the banking or retail sectors, which should result in increased activity in the small to mid-cap space for generalist funds. Possible large-cap transactions may involve banks, the energy sector, and listed real estate managers and developers, which may attract the interest of specialist funds. Secondary transactions and non-performing loan transactions should also play a role in 2015.

On 1 January 2015, the Federal Act on the Recovery and Resolution of Banks (BSAG) implementing the Bank Recovery and Resolution Directive[4] entered into force. The BSAG closely follows the BRRD, which, *inter alia*, provides for the writing down and conversion of the financial instruments of banks prior to the exploration of other measures that would affect taxpayers. The sequence for such write downs is as follows:

a common equity Tier 1;
b additional Tier 1 instruments;
c Tier 2 instruments;
d other subordinated debt; and
e the remainder of the eligible liabilities.

A number of specified types of liabilities are exempt, including secured liabilities, covered deposits, liabilities to employees and liabilities to tax and social security. The bail-in legislation should have an impact on the way banks raise capital. It may also create interest in hedge funds taking a chance on the instruments of banks.

4 2014/59/EU.

Appendix 1

ABOUT THE AUTHORS

MARTIN ABRAM

Schindler Rechtsanwälte GmbH

Martin Abram is a founding partner of Schindler and Partners. Before establishing the firm, he spent 15 years at Wolf Theiss, where he became a partner in 2002.

Mr Abram's practice focuses on corporate, real estate and financing work, with a particular focus on corporate and real estate mergers and acquisitions, corporate reorganisations and project and real estate financing. Furthermore, he is also active in equity capital market transactions and commercial and residential leasing transactions. His practice is complemented by general real estate work and contracts work.

Mr Abram holds law degrees from the University of Vienna and the University of Nottingham law school. He is admitted to the Austrian Bar.

Mr Abram has published articles regarding corporate and energy law, has contributed to several Wolf Theiss publications, and is an author and co-editor of a book on the general meeting of Austrian stock corporations.

FLORIAN PHILIPP CVAK

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Florian Philipp Cvak is a founding partner of Schindler and Partners. Before establishing the firm, he spent 14 years at Schoenherr, for the past five years as a partner. At Schoenherr, he co-headed the private equity practice and was involved in some of the firm's most prestigious transactions in Austria and the wider CEE region.

Mr Cvak's practise focuses on corporate and corporate finance transactions in Austria and CEE, with a particular focus on the areas of mergers and acquisitions, private equity, venture capital and LBO financings. Futhermore, he specialises in US lease and project finance transactions involving various types of utility assets. His practice is complemented by restructuring, general corporate and contracts work.

Mr Cvak holds law degrees from the University of Vienna and New York University Law School (LLM), and has attended extracurricular classes on private equity,

corporate finance, investment banking and accounting at New York University, Stern Business School.

Mr Cvak is admitted to the Austrian, the New York and Polish Bars. he has published several articles on M&A, private equity and corporate finance, and is a frequent speaker at conferences and seminars regarding private equity and corporate and M&A matters.

Mr Cvak is ranked by international legal directories such as *Chambers Global* and *Chambers Europe*. He was awarded Austrian private equity lawyer of the year by ACQ5 for 2013 and 2014, and is featured in the 2014 edition of *The Best Lawyers in Austria*. Besides its Austrian listings, *Chambers Global* acknowledges his Polish expertise in a special ranking on foreign experts based abroad.

CLEMENS PHILIPP SCHINDLER

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Clemens Philipp Schindler is a founding partner of Schindler and Partners. Before establishing the firm, he spent six years as partner at Wolf Theiss, where he led some of the firm's most prestigious transactions and headed its Brazil operations.

Prior to that, he practised with Haarmann Hemmlrath in Munich and Vienna, as well as with Wachtell Lipton Rosen & Katz in New York.

Mr Schindler's practice focuses on corporate and tax advice in relation to public and private M&A, private equity and corporate reorganisations (such as mergers, spin-offs and migrations), most of which have a cross-border element. Furthermore, he is specialised in international holding structures, including charter financing and leasing operations. His practice is complemented by private client work (e.g., as counsel to families owning stakes in large corporations).

Mr Schindler holds law degrees from the University of Vienna and New York University Law School (LLM) as well as a degree in business administration from the Vienna University of Economics and Business Administration.

Mr Schindler is admitted in Austria both as an attorney-at-law as well as a certified public tax adviser. He has authored and co-authored more than 50 articles, books and commentaries in his fields of expertise, where he is also much sought-after as a speaker at conferences and seminars.

Mr Schindler is ranked by international legal directors such as *Chambers Global*, *Chambers Europe*, *The Legal 500*, *IFLR1000* and *Who's Who Legal*. The German legal directory *JUVE* lists him as one of Austria's top 20 corporate and M&A lawyers. Besides their Austrian listings, *Chambers Global* and *Chambers Europe* acknowledge his Brazilian expertise in a special ranking on outstanding expertise in foreign jurisdictions.

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