Austria

Schindler Attorneys

Florian Philipp Cvak

Clemens Philipp Schindler

1 Overview

1.1 What are the most common types of private equity transactions in your jurisdiction? What is the current state of the market for these transactions? Have you seen any changes in the types of private equity transactions being implemented in the last two to three years?

Austria has seen the full spectrum of private equity transactions, from seed to growth capital transactions, to all sorts of equity buyout and non-performing loan or loan-to-own transactions.

At the top end, there were no particular trend and deals spread across all sorts of sectors. In the midmarket buyout segment (comprising deals with values between EUR 10 million and EUR 100 million which make up the vast majority of Austrian deals), on the other hand, technology and industrial products and services accounted for most of the deal flow and that trend is expected to continue. Real estate overall remained very hot with PE playing a lesser role, however. Midmarket deal structures increasingly involved a sellers' roll-over/reinvest structure. A trend that continued from 2016 is increased activity in the growth capital segment with corporate seed capital and venture capital funds becoming increasingly active, with traditional venture and growth capital funds and investors from Asia and the Far East also playing their roles. We expect that trend to continue and to contribute more to overall deal count over the coming years.

On the debt side, with the economy recovering non-performing loan transactions have become rather scarce. A rather new development is specialist debt funds which are increasingly active.

1.2 What are the most significant factors or developments encouraging or inhibiting private equity transactions in your jurisdiction?

See question 1.1. Another factor for Austrian transactions is that many companies have substantial CEE exposure which is perceived as an opportunity by some investors, but it is an issue for others who must not invest in targets in the CEE, or with considerable CEE exposure, pursuant to the terms of their investment mandate.

2 Structuring Matters

2.1 What are the most common acquisition structures adopted for private equity transactions in your jurisdiction? Have new structures increasingly developed (e.g. minority investments)?

The typical onshore acquisition structure involves one or more holding companies ("HoldCos") and an acquisition vehicle ("BidCo") which then enters into the purchase agreement and ultimately acquires the shares. From a tax perspective, this multi-layer holding structure is no longer necessary (see question 2.2). In leveraged transactions interim holding companies are, however, often still needed as senior lenders typically insist that junior lenders lend a level higher in the structure to achieve not only contractual subordination (which is achieved through an inter-creditor agreement), but also structural subordination of junior debt to senior debt.

Funds will usually try to maximise debt in the financing structure for a transaction. The difference between available bank debt and the purchase price is financed by the fund through a combination of debt (so called, "institutional debt") and equity. How much institutional debt can be employed, is determined by "thin cap" rules. Whereas there are no statutory rules in place, debt to equity ratios of 3:1 to 4:1 are generally accepted by the Austrian tax authorities.

Where bank debt is employed, banks usually require the target company to accede to the financing documents on an exclusive lender basis (to avoid structural subordination to incumbent borrowers) and to grant guarantees and security interests securing acquisition debt as well as the refinanced target company debt (see, exclusive lender basis) on or shortly after completion of the purchase. To the extent guarantees and security interests secure acquisition debt, capital maintenance and, where a joint stock company ("JSC") is involved, financial assistance rules are a concern. Transactions violating capital maintenance rules are null and void as between the parties as well as any involved third party (e.g. the financing bank) if that third party knew, or should have known, of the violation. In addition, the members of the management and supervisory board who approved the transaction may be subject to liability for damages. Transactions violating financial assistance rules, on the other hand, are not void but may result in liability of the members of the management and supervisory board who approved the transaction. This issue is addressed in the financing documents by "limitation language" which limits the obligations of Austrian obligors to an amount and terms compliant with capital maintenance and financial assistance rules.

2.2 What are the main drivers for these acquisition structures?

The availability of goodwill amortisation on share deals and capital tax considerations were the main drivers for onshore structures as described under question 2.1 above. Goodwill amortisation on share deals is no longer available and capital tax on direct parent capital contributions was abolished effective 1 January 2016. The Austrian HoldCos and the BidCo can, however, still enter into a tax group with the target. This allows for the off-setting of interest expenses with the taxable profits of the target. Where Austrian-based companies are not required for other reasons, the acquisition structure described in question 2.1 is often implemented offshore.

2.3 How is the equity commonly structured in private equity transactions in your jurisdiction (including institutional, management and carried interests)?

Institutional equity is usually given offshore and passed on to the Austrian structure by way of capital contributions. Management equity is often given in the form of actual shares, either in the target company (or the entity in which the exit is expected to occur) or shares in entities above.

From a tax perspective, actual shares (and certain other equity interests) may have benefits relative to phantom stock and other contractual bonus scheme arrangements, as gains realised upon an exit may be eligible for capital gains taxation as opposed to employment income.

2.4 What are the main drivers for these equity structures?

Please see the answer to question 2.3 above.

2.5 In relation to management equity, what are the typical vesting and compulsory acquisition provisions?

Management equity is typically subject to vesting over a period of three to five years. Compulsory transfer provisions apply upon termination of the management function, with the consideration varying depending on the reason for termination (a "good" or a "bad" leaver), although structures have become less aggressive in that regard due to recent developments in Austrian labour law. In addition, the private equity fund will require a right to drag along the management upon an exit and typically will insist on the pooling of the management equity in a pooling vehicle (often a partnership).

2.6 If a private equity investor is taking a minority position, are there different structuring considerations?

Private equity investors taking a minority position, typically insist on new governance documents (for a description, see question 3.1). Where that request is rejected, the investor must carefully analyse what rights are available to him following completion under the existing governance documents and, where necessary, request amendments. In that process, it is important to familiarise oneself with which minority protections are already available under the law, which of them are mandatory, which of them can be amended to the benefit of minority shareholders only, and which of them can be amended without restriction. Which protections are available differs depending on the type of company but, generally, minority shareholder protection includes information rights, rights to call a shareholders' meeting, quorum, and voting requirements for major corporate actions (such as corporate restructurings, a change of the company's purpose, changes to the articles of association, dealings involving all or substantially all of the business or assets, and squeeze-outs of shareholders).

3 Governance Matters

3.1 What are the typical governance arrangements for private equity portfolio companies? Are such arrangements required to be made publicly available in your jurisdiction?

The governance documents typically include:

- a shareholders' agreement;
- new articles of association; and
- by-laws for the management board and supervisory board (if any).

The main areas of concern in the governance documents are the private equity fund's rights to appoint sponsor representatives (and/or observers) to the supervisory board (if any) or advisory board (if any), sponsor representative liability, veto rights of the fund (and/or the sponsor representative) (see question 3.2), dilution protection for the fund, a liquidation preference for the fund, restrictions on dealings with shares (typically including a lock-up, rights of first refusal, tag-along, and drag-along rights), exit rights for the fund (via a trade sale, an IPO or a shotgun mechanism) as well as reporting, information and access rights.

In most cases, the fund will also insist that senior management signs up to an incentive scheme (see question 2.3) and that all of the management team (and sometimes also certain other key personnel) enter into new employment agreements at terms agreed with the fund.

To the extent the above arrangements are included in the articles of association (which have some benefits for some (but not all) of them from an enforcement perspective (see question 3.3)), they are publicly accessible through the companies register. In addition, certain arrangements may have to be disclosed if the target is a listed JSC and Securities Law disclosure requirements are triggered.

3.2 Do private equity investors and/or their director nominees typically enjoy significant veto rights over major corporate actions (such as acquisitions and disposals, litigation, indebtedness, changing the nature of the business, business plans and strategy, etc.)? If a private equity investor takes a minority position, what veto rights would they typically enjoy?

The governance documents will typically include veto rights of the fund (and/or a sponsor representative in a supervisory board) over major corporate actions and strategic decisions (such as acquisitions and disposals, major litigation, indebtedness, changing the nature of the business, business plans and strategy) although the specific requirements vary widely from fund to fund and deal to deal. Usually such veto rights are structured to fall away if the relevant fund's interest is reduced below a certain quota. Where multiple funds invest, they will generally insist that all investors vote on the veto matters, with quorum and majority voting requirements varying widely from deal to deal.

3.3 Are there any limitations on the effectiveness of veto arrangements: (i) at the shareholder level; and (ii) at the director nominee level? If so, how are these typically addressed?

If a veto (or majority) requirement is included in the articles of association (and/or by-laws), resolutions violating the arrangement can be challenged. In contrast, if a veto right (or majority requirement) set forth in the shareholders' agreement is violated, only an action for damages and cease and desist orders are available. It should be noted though, that in one decision the Austrian Supreme Court also accepted a challenge of a shareholders' resolution in breach of a majority requirement set forth in a shareholders' agreement. In that case all shareholders were a party to the agreement which will often be the case in private equity deals as well, at least where the shareholders' agreement provides for mandatory accession.

Regarding management board member action, it must be noted that towards third parties the power of representation of management board members cannot be limited in the shareholder's agreement, articles of association and/or by-laws in such a way that the company would not be bound if a member transacts in violation of any such limitations.

3.4 Are there any duties owed by a private equity investor to minority shareholders such as management shareholders (or vice versa)? If so, how are these typically addressed?

Austrian courts have consistently held that shareholders owe a duty of loyalty (*Treuepflicht*) towards one another requiring them to consider the interests of their fellow shareholders in good faith (*Treu und Glauben*) and in line with *bonos mores* (*gute Sitten*). That duty is more pronounced for closely held companies than for widely held companies and differs from shareholder to shareholder, depending on their ability to cause a certain action to be taken or not to be taken. A majority shareholder may therefore be exposed to liability for failure to appear and vote on a matter in circumstances where a minority shareholder is not (because his appearance or vote would not have mattered in the circumstances anyway). A violation of the duty of loyalty may result in claims for damages, cease and desist orders, or a challenge action (*Anfechtung*) of shareholder resolutions in violation.

3.5 Are there any limitations or restrictions on the contents or enforceability of shareholder agreements (including (i) governing law and jurisdiction, and (ii) non-compete and non-solicit provisions)?

Shareholders' agreements are typically governed by Austrian law and the competent courts at the seat of the company typically have jurisdiction. This is mainly because disputes related to shareholders' agreements are usually supported by arguments based on Austrian corporate law and corporate law disputes must be brought before the courts at the seat of the company. However, where Austrian court judgments are not enforceable in the jurisdiction of a particular shareholder, arbitration is an option.

Non-compete and non-solicitation provisions are generally enforceable for the period of the shareholding (for that period contractual restrictions compete with the corporate law based duty of loyalty (see question 3.4)) and for up to two (in exceptional cases, three) years thereafter. Where a shareholder was at the same time an employee (which could be the case for management shareholders), the restriction will also be scrutinised under employment law and is generally only valid for a period of up to one year and to the extent that the restriction does not unduly affect the employee's future prospects.

It should be noted that where a shareholders' agreement includes an obligation to transfer shares of a limited liability company (such as an option or a drag along right), it must be drawn up in the form of an Austrian notarial deed if the obligation to transfer is to be enforceable (note: a German notarial deed is considered equivalent).

3.6 Are there any legal restrictions or other requirements that a private equity investor should be aware of in appointing its nominees to boards of portfolio companies? What are the key potential risks and liabilities for (i) directors nominated by private equity investors to portfolio company boards, and (ii) private equity investors that nominate directors to boards of portfolio companies under corporate law and also more generally under other applicable laws (see section 10 below)?

General

Austria has a two-tier board structure. The management board is responsible for the day-to-day management of the company, while the supervisory board is responsible for monitoring and resolving on the matters brought before the supervisory board for a vote (which is a matter for the governing documents). Sponsors usually request rights to nominate one (or more) members of the supervisory board (*Aufsichtsrat*) or observers to the supervisory board, but hardly ever get involved in management. For that reason, the answers under questions 3.6 and 3.7 will focus on supervisory board nominees.

Restrictions

Restrictions with respect to the aggregate number of supervisory board positions and provisions aimed to prevent conflicts of interest exist: supervisory board members must not be managing directors of the portfolio company or of a subsidiary, or employees of the portfolio company (employee representatives are exempt from that restriction). They must not hold more than 10 (eight for a listed JSC) supervisory board positions (with chairman positions counting double and exemptions for group positions), or be appointed a managing director of a subsidiary or of another company to whose supervisory board a member of the management board of the portfolio company is appointed (unless that company belongs to a corporate group (*Konzern*)).

Requirements

Corporate law does not require a specific qualification or experience for supervisory board members. Such requirements can be introduced in the articles of association. As a general matter, however, every supervisory board member must ensure that it can meet its duty of care (*Sorgfaltspflicht*) requiring the relevant member to exercise the level of care of a proper and diligent supervisory board member of the particular company to which supervisory board he is appointed (that is, a supervisory board member of a biotech company will have to have different knowledge and skills from a supervisory board member of a company that is in the shoe retail business). In general terms, a supervisory board member must have at least a basic understanding of the business brought before the supervisory board, have an understanding of annual accounts, and be able to assess when expert opinions are required and devote sufficient time.

Risks and liability

Members of the supervisory board owe to the portfolio company (and not to the private equity investor appointing them or to any other constituents) a duty of care (*Sorgfaltspflicht*) (see above – which includes an obligation to be reasonably informed and articulate any

concerns he may have); a duty of loyalty (*Treuepflicht*) (requiring the member to act in the best interest of the company and its shareholders and not in his own interest); and a duty of confidentiality. A supervisory board member is not prevented from competing with the business of the portfolio company, as long as there is no breach of the duty of loyalty. Absent a breach of their corporate duty of care, supervisory board members can generally not be held liable for a portfolio company's breach of administrative law or criminal law. A supervisory board member may, however, become liable for their own conduct, including, without limitation, for fraud (*Betrug*) (e.g. by entering or approving a transaction intended to mislead another); for breach of trust (*Untreue*) (e.g. by entering or approving a transaction that is adverse to the interests of shareholders); or for misrepresentation (e.g. with regard to the portfolio company's assets, financial or earning position or related information in the financial accounts or in a public invitation to purchase shares, statements in a shareholders' meeting, statements to the company's auditors, in companies register filings) or for violations of anti-bribery legislation (see section 10 below).

A private equity investor will generally not be held responsible for an act or a failure to act of a member of the supervisory board just because that member was nominated by the investor. However, whenever there is involvement beyond that, the investor could face criminal law penalties and civil law liability for damages (e.g. where the investor has collaborated with the member on a transaction intended to mislead another or which is adverse to the interests of shareholders (see above)). In addition, in circumstances where a sponsor nominee who at the same time is a decision taker of the investor within the meaning of the Association Responsibility Act (*Verbandsverantwortlichkeitsgesetz – VbVG*) commits a criminal offence for the benefit of the investor, the private equity investor may face criminal law penalties and civil law liability for damages. Further, the private equity investor could face civil law liability based on corporate law for trying to influence members of the management or supervisory board to his own benefit or the benefit of another (e.g. requiring management to pay the fund's transaction costs, or influencing management so that a business opportunity is not pursued and remains available for another portfolio company of the investor).

3.7 How do directors nominated by private equity investors deal with actual and potential conflicts of interest arising from (i) their relationship with the party nominating them, and (ii) positions as directors of other portfolio companies?

Where a sponsor nominee director has a conflict of interest with respect to any matter, he has to advise the chairman of the supervisory board accordingly; the chairman of the supervisory board is then asked to make sure that the sponsor nominee director does not vote with respect to the matter and does not participate in related meetings.

4 Transaction Terms: General

4.1 What are the major issues impacting the timetable for transactions in your jurisdiction, including competition and other regulatory approval requirements, disclosure obligations and financing issues?

The following clearance requirements are typically a factor for the timetable:

- antitrust clearance (which takes up to four weeks if cleared in phase one proceedings and up to five months if cleared in phase two proceedings in Austria);
- regulatory clearance (e.g. the acquisition of a qualified or controlling interest in the banking, insurance, utilities, gambling, telecoms or aviation sector is subject to advance notification or approval of the competent regulatory authority);
- real estate transfer clearance (the acquisition of title and certain other interests in real estate by non-EEA nationals, or control over companies holding such interests, is subject to advance notification or approval (depending on the relevant state law); and
- clearance pursuant to the Foreign Trade Act (*Außenwirtschaftsgesetz*) (the acquisition of 25% or more or of a controlling interest in an Austrian business involved in certain protected industries, such as defence, security services, hospitals, emergency and rescue services, energy and water supply, telecoms, traffic or universities by a non-EEA or non-Swiss national is subject to advance approval of the Austrian Minister of Economic Affairs (before the transaction is signed).

With regard to timing aspects related to public-to-private transactions, see question 5.1.

4.2 Have there been any discernible trends in transaction terms over recent years?

Vendor due diligence is becoming more and more common in auctions of bigger targets (sometimes coupled with reliance and/or warranties given by the seller or the management on the vendor due diligence report, sometimes without). Similarly, warranty and indemnity insurance is more frequently discussed, in particular where private equity investors are sellers.

5 Transaction Terms: Public Acquisitions

5.1 What particular features and/or challenges apply to private equity investors involved in public-to-private transactions (and their financing) and how are these commonly dealt with?

A typical going-private transaction involves a voluntary takeover offer aimed at control (*freiwilliges Angebot zur Kontrollerlangung*), subject to the condition that 90% of the outstanding shares are tendered, followed by a squeeze-out pursuant to the Shareholders Exclusion Act (*Gesellschafterausschluss-Gesetz*). The squeeze-out then automatically results in a so-called "cold delisting". Since January 2018, where the target is listed on the prime market of the VSE the target can alternatively also apply for (a regular) delisting following a takeover offer (which requires a shareholder resolution with ¾ majority and a bid within six months prior to the resolution).

In the context of the takeover offer, the private equity investor must ensure that the necessary funds are secured prior to the announcement of the offer which must be confirmed by an independent expert pursuant to the Austrian Takeover Code (*Übernahmegesetz*). The expert will typically require (i) a copy of the equity commitment letter from the fund, and (ii) copies of the definitive finance agreements together with documents evidencing that all conditions precedent (other than those within the private equity investor's sole control) have been satisfied, to satisfy itself that the necessary funds requirement has been satisfied.

5.2 Are break-up fees available in your jurisdiction in relation to public acquisitions? If not, what other arrangements are available, e.g. to cover aborted deal costs? If so, are such arrangements frequently agreed and what is the general range of such break-up fees?

Break-up fees obligating the target company to pay a fee to the bidder if the bid fails in a public acquisition are in principle available, but they are not common. There is little guidance, but whether a break-up fee is valid or not should primarily depend on two factors: (i) the amount of the fee (a break-up fee in an amount that will keep management from considering competing bids or deter others from considering a competing bid will probably not be valid); and (ii) the circumstances in which it is triggered (a break-up fee that is solely triggered upon active solicitation of competing bids should be valid, whereas a break-up fee triggered because a bid is not supported for good reason, or because a better competing bid is supported, is probably not valid).

6 Transaction Terms: Private Acquisitions

6.1 What consideration structures are typically preferred by private equity investors (i) on the sell-side, and (ii) on the buy-side, in your jurisdiction?

Private equity investors tend to prefer locked box structures, particularly when they are on the sell-side. Where the gap between signing and the anticipated date of closing is long (e.g. because of antitrust or other clearance requirements) closing adjustments are the norm. Which parameters are included in a closing adjustment depends on the target business, with the most common combination being adjustments for net debt, working capital, and (sometimes) capex. Equity adjustments are relatively rare.

6.2 What is the typical package of warranties/indemnities offered by a private equity seller and its management team to a buyer?

Experienced private equity sellers will try to avoid business warranties and indemnities (and instead just provide warranties on title and capacity). In addition, experienced private equity sellers will be very keen to limit recourse for warranty claims (e.g. to an amount paid into escrow) as well as any other post-closing liability.

Where private equity sellers are forced to give business warranties, they will seek back-to-back warranties from management and underwrite a seller's warranty and indemnity insurance policy (see the discussion in question 6.4 below) or offer the buyer management warranties instead (which are usually linked to a buyer's warranty and indemnity insurance policy). The latter structure has the benefit that the private equity seller will not have to concern himself with post-closing warranty litigation.

6.3 What is the typical scope of other covenants, undertakings and indemnities provided by a private equity seller and its management team to a buyer?

Private equity sellers will try to limit post-completion covenants to access books and records and sometimes assistance in relation to pre-completion affairs. Usually buyers will insist on non-compete and non-solicitation covenants (which private equity sellers will typically try to resist). Other post-completion covenants will depend on the particular case and may include covenants on de-branding, migration, transitional services, and dealings regarding group security interests and guarantees.

6.4 Is warranty and indemnity insurance used to "bridge the gap" where only limited warranties are given by the private equity seller and is it common for this to be offered by private equity sellers as part of the sales process? If so, what are the typical (i) excesses / policy limits, and (ii) carve-outs / exclusions from such warranty and indemnity insurance policies?

Private equity sellers sometimes use warranty and indemnity insurance to "bridge the gap". Seller policies are usually not discussed in the course of the sales process unless the buyer is expected to bear all or part of the costs. Conversely, flipping policies (that is a policy organised by a seller as part of an auction process which flips into a buyer's policy) are usually an incremental part of the auction documentation. The typical excess is around 1% of the consideration. Policy limits vary between seller policies (usually they match the agreed maximum liability under the purchase agreement) and buyer policies (usually they start at around 20% of the enterprise value but can also cover the full enterprise value). Typical carve-outs and exclusions include fraud, matters the insured was aware of at the time of taking insurance, and forward-looking warranties (e.g. the ability to collect accounts receivables). Indemnities for risks identified in the course of the due diligence can sometimes be insured as part of the policy, if the contingent risk is identifiable and quantum and likelihood assessable.

6.5 What limitations will typically apply to the liability of a private equity seller and management team under warranties, covenants, indemnities and undertakings?

Limitations on warranties

Common limitations on warranties include:

- Time limitation for bringing claims:
  - title and capacity warranties usually survive 10 years at the minimum;
  - business warranties between 12 and 24 months;
  - tax warranties typically around seven years; and
  - environmental warranties five to 10 years.
- Financial limits, including:
  - a cap on the total liability (where there are multiple sellers, each may seek to limit its liability *pro rata*);
  - a minimum aggregate claims threshold ("basket"); and
  - an exclusion of *de minimis* claims.
- Limitation to direct loss (as opposed to indirect and consequential loss).
- Exclusion of claims to the extent caused by:
  - agreed matters;
  - acts of the purchaser (outside of the ordinary course of business);
  - change of law or interpretation of law; or
  - change of tax or accounting policies.
- No liability for contingent liabilities.
- No liability if the purchaser knew or could have known.
- No liability for mere timing differences (e.g. if tax authorities request longer tax depreciation periods).
- Obligation to mitigate loss.

- No double recovery under warranties, indemnities and insurance policies.
- A conduct of claims provision.

Qualifying warranties by disclosure

Warranties are usually qualified by matters that have been disclosed (in a certain manner) or are deemed disclosed by operation of the provisions of the acquisition agreement or the disclosure letter (e.g. information which can be obtained from publicly accessible registers). The seller will always push for general disclosure (i.e. everything disclosed to the purchaser and its advisors at whatever occasion qualifies all warranties) while the purchaser will push for specific disclosure (i.e. separate disclosure for each warranty) and try to introduce a disclosure threshold requiring that a matter must be "fully and fairly" disclosed. This is usually heavily negotiated.

Limitations on indemnities

Indemnities are generally not qualified by disclosure or knowledge. The tax indemnity is usually only subject to a specific tax conduct provision, a direct loss limitation and the overall cap. Other limitations are a matter of negotiation. If other indemnities (e.g. for contamination and environmental compliance or specific due diligence findings) are accepted, limitations are usually heavily negotiated.

6.6 Do (i) private equity sellers provide security (e.g. escrow accounts) for any warranties / liabilities, and (ii) private equity buyers insist on any security for warranties / liabilities (including any obtained from the management team)?

Private equity sellers are generally prepared to provide security but will, in turn, often require that the buyer's recourse is limited to such security (see question 6.2). Whether or not private equity buyers insist on security depends on various factors, including the set of agreed warranties and the credit of the seller (that is where the seller is a listed corporate there is less need for security than in the case of a secondary transaction where the seller is a SPV or where business warranties come from management only).

6.7 How do private equity buyers typically provide comfort as to the availability of (i) debt finance, and (ii) equity finance? What rights of enforcement do sellers typically obtain if commitments to, or obtained by, an SPV are not complied with (e.g. equity underwrite of debt funding, right to specific performance of obligations under an equity commitment letter, damages, etc.)?

Private equity buyers will typically be willing to provide a copy of the executed equity commitment letter from the fund and copies of the definitive financing agreements together with documents evidencing that all conditions precedent (other than those within the private equity investor's sole control) have been satisfied, to provide comfort that the necessary funds will be available at closing. If those financing commitments are not complied with, sellers are typically limited to claims for damages. Equity underwriting of debt funding is the exception but, in situations where definitive financing agreements are not in place at signing, experienced sellers will insist on an equity underwrite, particularly in auctions (to limit execution risks).

6.8 Are reverse break fees prevalent in private equity transactions to limit private equity buyers' exposure? If so, what terms are typical?

Reverse break fees as a means to limit a private equity buyer's exposure in case the necessary financing is not available at closing are not very common in Austria. If they are agreed, they are typically linked to a financing condition (that is where the financing is not available at closing, the private equity buyer can withdraw from the contract but has to pay the reverse break fee to the seller). If structured that way (i.e. a condition linked to a withdrawal right), the amount of the fee should not be subject to judicial review. Conversely, if the reverse break fee is structured as a contractual penalty for failure to close, the amount of the fee would be subject to judicial review.

7 Transaction Terms: IPOs

7.1 What particular features and/or challenges should a private equity seller be aware of in considering an IPO exit?

An IPO exit requires that the articles of association and bylaws are adjusted, a due diligence is performed and a prospectus is prepared. In addition, the company will have to enter into an underwriting agreement and management will have to participate in road shows. All of that requires the cooperation of the company and (at least) where no new shares are issued, the management will typically ask the private equity seller to bear most of the associated costs (based on an argument related to capital maintenance rules). Any new shares issued in the IPO will naturally limit the number of shares the private equity seller can sell into the IPO. In addition, the underwriting agreement will usually provide for lock-up restrictions (see question 7.2) which limit the private equity seller's ability to sell any shares it has retained following the IPO. Finally, the private equity seller will usually be asked to give warranties in the underwriting agreement. In most cases the private equity seller will be able to limit those warranties to matters relating to the private equity fund and the shares it sells into the IPO. Sometimes director nominees are also required to give warranties.

7.2 What customary lock-ups would be imposed on private equity sellers on an IPO exit?

The underwriting banks will usually expect some of the private equity seller's shares to be locked-up for a period of about 180 days. In addition, lock-up requirements may already be included in the shareholders' agreement, but this is rather the exception.

7.3 Do private equity sellers generally pursue a dual-track exit process? If so, (i) how late in the process are private equity sellers continuing to run the dual-track, and (ii) were more dual-track deals ultimately realised through a sale or IPO?

Dual-track processes are rare in Austria. As far as we are aware there have only been a few attempts in the last couple of years, all of which ultimately resulted in a trade sale.

8 Financing

8.1 Please outline the most common sources of debt finance used to fund private equity transactions in your jurisdiction and provide an overview of the current state of the finance market in your jurisdiction for such debt (particularly the market for high yield bonds).

Sources of debt finance for private equity transactions differ substantially for domestic private equity buyers, who typically

finance all equity or seek debt finance from domestic banks, and international private equity buyers, who are able to tap international markets.

Leverage levels for large-cap buyouts have gone up in 2017 to around five to six times EBITDA and relative debt to equity ratios of 50% to 70%. Mid- and small-cap transactions are sometimes financed through equity only. Leverage levels and debt to equity ratios for mid- and small-cap transactions tend to be lower than for large-cap buyouts.

On mid- and small-cap transactions there is usually just senior and institutional debt as the additional transaction costs associated with mezzanine debt are often not supported by the limited transaction size. On large-cap transactions it is a matter of pricing whether mezzanine debt is applied. High-yield is usually only considered for post-completion refinancing but not for the financing of the (original) purchase price.

8.2 Are there any relevant legal requirements or restrictions impacting the nature or structure of the debt financing (or any particular type of debt financing) of private equity transactions?

Please see the answer to question 2.1.

9 Tax Matters

9.1 What are the key tax considerations for private equity investors and transactions in your jurisdiction? Are off-shore structures common?

Usually, 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:

(1) 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 company 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 company 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.

(2) A second method, which is sometimes discussed but rarely ever 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 downstream 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 to the financing banks. 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 the necessary arguments.

Regarding a future exit it should be taken into account that double taxation treaties usually assign the right to tax capital gains to the state of residence of the shareholder. For that reason, a foreign seller will usually not be taxed on the capital gains in Austria. If, however, the seller is an Austrian tax resident, capital gains taxation applies (i.e. no participation exemption is available for Austrian tax residents in relation to Austrian targets).

Avoidance of withholding taxes on dividends is usually less of an issue, since pre-exit distributions are very rare. Still, to address that issue, EU entities are usually preferred over non-EU entities and, among the latter, entities from countries with which Austria has concluded a double taxation treaty.

9.2 What are the key tax considerations for management teams that are selling and/or rolling-over part of their investment into a new acquisition structure?

Generally, an exchange of shares is treated in the same way as a sale of shares and will thus trigger capital gains taxation. Assuming that management holds only a small percentage in the target, the only option to roll-over their shares without triggering capital gains taxation is to contribute their shares into a company that, through such additional shares, either establishes or enlarges a majority position in the target.

9.3 What are the key tax-efficient arrangements that are typically considered by management teams in private equity portfolio companies (such as growth shares, deferred / vesting arrangements, "entrepreneurs' relief" or "employee shareholder status" in the UK)?

There is no specific regime that provides for tax reliefs or other tax benefits of substantial nature to management teams. It is therefore important to ensure that capital gains taxation (27.5%) applies as opposed to taxation as employment income under general tax rules (up to 55%) (see question 2.3 above).

9.4 Have there been any significant changes in tax legislation or the practices of tax authorities (including in relation to tax rulings or clearances) impacting private equity investors, management teams or private equity transactions and are any anticipated?

Capital duty on direct capital contributions was, however, abolished, effective as of 1 January 2016, which means acquisition structures will become simpler as interim HoldCos, previously needed for capital duty reasons, will no longer be required. Already since 2014, goodwill amortisation is no longer available on share deals (which required the establishment of a tax group). The latter will likely lead to more foreign BidCos, unless offsetting interest expenses incurred in financing the acquisition from the profits of the target is a major concern.

Tax rulings are becoming more common, after a new ruling regime providing for binding tax rulings in the areas of reorganisations, group taxation and transfer pricing was introduced a few years ago. From 1 January 2019 binding tax rulings will also be available in the areas of international taxation, value added tax and questions in connection with abuse. On the buy-side tax rulings are less common. However, we increasingly see rulings e.g. in relation to pre-exit reorganisations, such as a carve-out of a certain division which shall be sold separately.

In addition, the implementation of the EU Anti-BEPS Directive is currently in preparation. The following rules on CFC and new anti-avoidance rules shall be introduced 1 January 2019.

The parties should also consider changes in relation to real estate transfer tax (that is, a lower share consolidation threshold (now 95% compared to 100% previously) and full attribution of shares held in trust to the trustor) whenever real estate is involved in a transaction.

10 Legal and Regulatory Matters

10.1 What are the key laws and regulations affecting private equity investors and transactions in your jurisdiction, including those that impact private equity transactions differently to other types of transaction?

With regard to recent legislation affecting managers of private equity funds, see the discussion in question 10.2 below. With regard to transactions, private equity investors should be aware of the general clearance requirements (see question 4.1).

10.2 Have there been any significant legal and/or regulatory developments over recent years impacting private equity investors or transactions and are any anticipated?

The most significant recent development impacting the private equity industry was the implementation of the AIFMD (EU Directive 2011/61/EU) by the Austrian Alternative Investment Manager Act (*Alternatives Investmentfonds Manager-Gesetz – AIFMG*). Private equity funds typically qualify as alternative investment funds (AIF). Managers of an AIF (AIFM) require a licence from the Austrian Financial Market Authority (*Finanzmarktaufsichtsbehörde – FMA*), unless the AIF qualifies for the *de minimis* exception (which applies to managers of small AIFs with assets of less than EUR 100 million (where leverage is used) or less than EUR 500 million (where no leverage is used), in which case they only need to register with the FMA.

10.3 How detailed is the legal due diligence (including compliance) conducted by private equity investors prior to any acquisitions (e.g. typical timeframes, materiality, scope etc.)? Do private equity investors engage outside counsel / professionals to conduct all legal / compliance due diligence or is any conducted in-house?

Private equity buyers tend to run a rather detailed issue-focused due diligence with relatively high materiality thresholds, which often concentrate on a very detailed analysis of a few value driving items. The timeframe depends very much on whether it is a proprietary situation (in which case the due diligence can take eight to 10 weeks or even more) or an auction (in which case the timing is driven by the auction process). With a few exceptions, private equity buyers active in Austria do not have the resources to run all legal and compliance due diligence in-house.

10.4 Has anti-bribery or anti-corruption legislation impacted private equity investment and/or investors' approach to private equity transactions (e.g. diligence, contractual protection, etc.)?

Anti-bribery and anti-corruption legislation had a significant impact on private equity transactions in Austria. Since their enactment, more emphasis is placed on those areas in the due diligence process as well as in the purchase or investment agreement. In addition, private equity firms will typically insist that a tight compliance system is put in place following closing. Provided it is appropriately monitored, such system can serve as a defence for potential management and portfolio company liability in case of an administrative and criminal offence by representatives of the portfolio company under Austrian law. In addition, international private equity investors should also be concerned with any additional requirements under the UK Bribery Act and the US Foreign Corrupt Practices Act as both of them claim extra-territorial jurisdiction.

10.5 Are there any circumstances in which: (i) a private equity investor may be held liable for the liabilities of the underlying portfolio companies (including due to breach of applicable laws by the portfolio companies); and (ii) one portfolio company may be held liable for the liabilities of another portfolio company?

In principle, a private equity investor is not liable for the liabilities of an underlying portfolio company. Exceptions apply, *inter alia*, under concepts of piercing the corporate veil, including (i) where the private equity investor factually manages, or substantially controls the management of, the underlying portfolio company (*faktische Geschäftsführung*), (ii) in cases of undercapitalisation (only where there is an obvious unbalance between the risks of the business and the equity which is likely to result in a default), (iii) where based on the accounting records, the assets of the company cannot be separated from the assets of the private equity investor (*Sphärenvermischung*), and (iv) in cases of shareholder action putting the portfolio company at risk (*existenzvernichtender Eingriff*) (where the investor takes action causing insolvency (*Insolvenzverursachung*), e.g. acceleration of a loan in distress).

In addition, a private equity investor may become liable to a creditor up to the amount secured where the private equity investor granted a guarantee or security interest securing a loan of a portfolio company in a "crisis" (as such term is defined in the Company Reorganisation Act (*URG*)). In such circumstances the portfolio company can request the creditor to claim against the private equity investor first (in which case the recourse claim of the private equity investor against the portfolio company is suspended until the crisis is over); in addition, if the portfolio company pays the creditor, the portfolio company can take recourse against the private equity investor.

The above principles apply *mutatis mutandis* in relation to the risk of potential liability of one portfolio company for the liabilities of another portfolio company.

11 Other Useful Facts

11.1 What other factors commonly give rise to concerns for private equity investors in your jurisdiction or should such investors otherwise be aware of in considering an investment in your jurisdiction?

Foreign private equity investors frequently find it difficult to access Austrian businesses, in particular family-owned businesses. For that reason they often find it useful to team up with a local partner or initiate the contact through trusted advisors.

Florian Philipp Cvak

Schindler Attorneys
Tuchlauben 13
1010 Vienna
Austria

Tel: *+43 1 512 2613*
Email: *florian.cvak@schindlerattorneys.com*
URL: *www.schindlerattorneys.com*

Florian's practice is focused on corporate and finance law, in particular for private equity clients. Florian is admitted to the Austrian, New York and Polish Bar. Before establishing the firm as a co-founder, Florian was a partner at Schoenherr, where he co-headed the private equity practice and was involved in some of the firm's most prestigious private equity transactions in Austria as well as the wider CEE region. Florian received the following awards and is ranked in:

- *Chambers Europe.*
- *Chambers Global.*
- *The Legal 500.*
- *IFLR1000.*
- *Best Lawyers in Austria* – (Best Lawyers).
- Private Equity Lawyer of the year – Austria (ACQ).
- Format (as one of the top 10 CEE lawyers in Austria).

Clemens Philipp Schindler

Schindler Attorneys
Tuchlauben 13
1010 Vienna
Austria

Tel: *+43 1 512 2613*
Email: *clemens.schindler@schindlerattorneys.com*
URL: *www.schindlerattorneys.com*

Clemens' transactional practice is focussed on corporate and tax. He is admitted both as a lawyer and a certified public tax advisor in Austria. Before establishing the firm as a co-founder, Clemens spent six years as partner at Wolf Theiss, where he led some of the firm's most prestigious transactions. Prior to that, he practised with Haarmann Hemmelrath in Munich and Vienna, as well as with Wachtell Lipton Rosen & Katz in New York. Clemens' 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. Clemens is ranked in:

- *Chambers Europe.*
- *Chambers Global.*
- *The Legal 500.*
- *IFLR1000.*
- *The International Who's Who of Corporate/M&A Lawyers.*
- *The International Who's Who of Corporate Tax Lawyers.*
- *Best Lawyers in Austria* – (Best Lawyers).
- *JUVE* (as one of the top 20 Corporate/M&A lawyers in Austria).
- *TREND* (as one of the top 10 corporate lawyers in Austria).

SCHINDLER
ATTORNEYS

Schindler Attorneys is a leading Austrian law firm focused on transactional work, with a strong focus on private equity. The members have an impressive track record in private equity and an excellent understanding of the needs of financial sponsors. The firm's integrated tax practice is a key differentiator from other firms on the Austrian market and is particularly appreciated by financial sponsors for acquisition structuring; incentive schemes can be handled in-house. The firm usually acts for financial sponsors, but sometimes advises banks on the financing of buyout transactions as well.