PANORAMIC

PRIVATE EQUITY (TRANSACTIONS)

Austria

LEXOLOGY

Private Equity (Transactions)

Contributing Editor

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TRANSACTION FORMALITIES, RULES AND PRACTICAL CONSIDERATIONS

Types of private equity transactions

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

Austria has seen the full spectrum of private equity transactions, from seed and growth capital to buyout transactions. Auctions have become quite unpopular with many funds because of fierce competition. Negotiated deals, on the other hand, typically involve a large amount of management time. On the debt side, dedicated debt funds are becoming ever more active in Austria, most of them focusing on the term loan in a leveraged buyout (LBO) (with a commercial bank typically providing the working capital facility for the target) or standalone growth capital debt financings (with or without an equity kicker). Non-performing loan transactions (that is, the purchase of secured and unsecured loans by a private equity fund from a financial institution aiming to restructure its balance sheet) and loan-to-own transactions (that is, where a private equity fund acquires (often shareholder) debt or grants a loan with the ultimate aim to convert that debt into equity (which can either be through a contractual mechanism (eg, under a convertible loan or note) or forced in the course of a restructuring) have become less frequent.

In a typical private equity acquisition of shares or a business, the private equity fund will acquire the shares or assets through a special purpose vehicle, which is funded by a combination of equity (provided by the private equity fund and sometimes management) and debt (provided by the financing banks or a debt fund). Debt transactions are structured similarly to bank lending transactions, with rather limited specifics in the loan documentation in the case of growth capital deals and certain additional complexities related to intercreditor issues in the case of LBO deals.

Law stated - 15 Februar 2024

Corporate governance rules

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

The level of regulation for a joint-stock company (JSC) is greater than for a limited liability company (LLC) or a partnership (eg, a JSC is subject to stricter rules on corporate governance and accounting) and again increases if the JSC is listed (eg, a JSC that is listed on the Prime Market of the Vienna Stock Exchange is subject to mandatory disclosure and reporting regulations as well as additional disclosure and reporting obligations of the Code of Corporate Governance, some require the issuer to comply or explain and others are recommendations only). For that reason, private equity firms will typically seek to take a listed target private to benefit from reduced regulation as well as reduced costs. Further, changes to the management board and supervisory board of a (listed) JSC are more difficult and time-consuming to implement than in the case of an LLC.

Law stated - 15 Februar 2024

Issues facing public company boards

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

As a general rule, the management board of a JSC is required to promote the interests of the company and consider the interests of its shareholders, employees and other stakeholders. Where the JSC is listed, the management board must also take measures to prevent market manipulation and insider trading and must avoid any inaccurate public statements. Additional obligations apply whenever a takeover bid is involved. Most importantly, the management board must not take measures that could prevent the shareholders from taking a free and informed decision with respect to the takeover bid. Further, the management board must seek the approval of the shareholders' meeting prior to implementing measures that could frustrate an announced takeover bid. The solicitation of a competing bid is specifically allowed.

Where members of the management board or the supervisory board are participating in a transaction or otherwise have an interest in a transaction, they have to notify the company accordingly and will generally not be permitted to vote with respect to the transaction or to participate in associated meetings. In addition, where the transaction involves a takeover bid, the relevant member of the management board or supervisory board must not participate in the preparation of the joint statement on the takeover bid of the management board and the supervisory board (required to be issued under the Takeover Act).

Law stated - 15 Februar 2024

Disclosure issues

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

General

A going-private transaction aimed at full control typically involves a voluntary takeover bid aimed at control which is then followed by a squeeze-out of the remaining minorities and a delisting. In order for a squeeze-out (pursuant to the Shareholder Exclusion Act) to work, the bidder will have to own directly or indirectly 90 per cent of the share capital and apply for a respective shareholder resolution to be adopted with a simple majority of the votes cast and the consent of the bidder. Minority shareholders cannot block the squeeze-out but can under certain circumstances request a review of the consideration (see 'Timing considerations' below). This 90 per cent threshold is why bidders aiming at full control will usually make their offer conditional upon reaching that threshold. A voluntary delisting (without squeeze out) requires shareholder approval with a majority of 75 per cent of the votes cast. Where the minorities are not a concern, bidders will thus aim to control at least 75 per cent of the share capital and often make their offer conditional upon reaching that threshold.

Disclosures

Shareholding

A person directly or indirectly acquiring or disposing of shares (the scope is broader and includes various instruments such as options) of a listed company admitted to trading on a regulated market is required to notify the target, the stock exchange and the Financial Market Authority if, as a result of such transaction, they reach, exceed or fall below a certain voting rights thresholds (4, 5, 10, 15, 20, 25, 30, 35, 40, 45, 50, 75 and 90 per cent of the votes; if the articles of association provide for it, the entry threshold is as low as 3 per cent) under the Stock Exchange Act. In addition, an acquisition of a direct or indirect interest conferring more than 26 per cent but not more than 30 per cent of the voting rights of a listed company must be notified to the Takeover Commission without delay and in any event within 20 trading days. The Takeover Act requires certain disclosures to be made in the takeover offer document, including with regard to the bidders' strategic planning and business and if a (voluntary) delisting is intended following completion of the takeover.

In addition, when an alternative investment manager (AIFM) acquires, sells or holds shares in a non-listed company, the AIFM managing the relevant alternative investment fund (AIF) must notify the Financial Market Authority of the share of voting rights in the non-listed company held by the AIF whenever this share reaches, exceeds or falls below certain thresholds (10, 20, 30, 50 and 75 per cent). If an AIF, alone or jointly, acquires control of a non-listed company, the AIFM managing the relevant AIF must inform the non-listed company concerned, its shareholders and the body regulating the relevant AIFM.

Further disclosure obligations

Apart from regulatory and real estate notice and clearance requirements, the following (more administrative) disclosure and filing requirements must be considered:

- the Commercial Register Act (FBG) requires management of the target company to file changes in the shareholder structure it becomes aware of with the competent companies register;
- the Beneficial Owners Register Act (WIEREG) requires certain information on the beneficial owners (ie, persons directly or indirectly controlling 25 per cent) to be filed with a transparency register; and
- ZABIL requires certain information on foreign direct investments of more than 10 per cent to be notified to the Austrian national bank for statistical purposes.

Law stated - 15 Februar 2024

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

Going-private transactions

The Takeover Act includes various requirements and deadlines which drive the timeline of a going-private transaction. For example, the bidder will be required to submit the offer document to the Takeover Commission within 10 trading days following the announcement of an offer (may be extended up to 40 trading days by the Takeover Commission). The offer document then has to be published within a further 12 to 15 trading days unless the Takeover Commission prohibits its publication or extends the review period. The offer must remain open for acceptance for between four and 10 weeks of its publication. Following the acceptance period, the results of the offer are published. If a mandatory offer or a conditional offer is successful, the bidder must afford the shareholders an additional three-month period to accept the offer. A competing bid automatically extends the offer period until the end of the competing bid period. Further timing considerations specific to going-private transactions relate to the delisting and squeeze-out.

General timing considerations

Timing considerations that apply equally to public and private transactions include the time required for due diligence and to obtain antitrust and regulatory clearance, the required third-party approvals or to implement any agreed pre-closing restructuring.

In the case of a going-private transaction, the due diligence is done before the announcement of the bid and usually has to rely for the most part on publicly available information. This is because the target's management board must carefully balance the bidder's need for disclosure against legal and contractual secrecy obligations, and its fiduciary duties to its shareholders. The target's management board must always remain neutral and objective in relation to competing bidders and must provide the same information to all bidders or potential bidders acting in good faith.

Where a target is shopped via an organised auction process, timing will largely depend on the process. The usual time frame for auctions in Austria is three to six months.

Law stated - 15 Februar 2024

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

The rights of minority shareholders differ depending on the way the delisting is effected. In structures involving a squeeze-out, minority shareholders cannot block the transaction but they can seek to challenge the squeeze-out transaction for breach of procedure. They can also request a review of the cash consideration offered for their shares by a court (ie, a fairness review). If the squeeze-out is implemented following a takeover bid pursuant to the provisions of the Shareholders Exclusion Act and the shareholders' resolution on the squeeze-out is passed within three months of the lapse of the offer period, there is a rebuttable presumption that the consideration offered is adequate if it amounts to the highest consideration paid during the offer period. This presumption is not available if the squeeze-out is made through other structures. Where no squeeze-out is involved in a going-private transaction (eg, the takeover offer is followed by a voluntary delisting), Austrian courts have so far not granted a cash-out right.

Law stated - 15 Februar 2024

Purchase agreements

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

While purchase agreements in private equity transactions largely follow the same structure as other purchase agreements, there are some specificities. A private equity seller will typically not be willing to give business warranties but will try to limit warranties to title, capitalisation and capacity and limit recourse for breach of warranty or indemnification to amounts put in escrow or recoverable from warranty and indemnity insurance. Where management or the founders sell along the private equity fund, they sometimes give business warranties but the caps are relatively low and as such those warranties are more designed to elicit proper disclosure. Private equity sellers will almost always sell on the basis of a locked box mechanism (that is, value is fixed by reference to a set of locked box accounts and the seller covenants that there will be no value leakage).

Where a private equity fund is the purchaser, sellers should require an 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 fund's control) have been satisfied on or around signing. More aggressive sellers sometimes push for an equity underwrite of the full purchase price.

Law stated - 15 Februar 2024

Participation of target company management

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

In buyout transactions, the private equity fund often involves future management in the due diligence process, business planning and financial modelling. Typically, management is offered the opportunity (and in most cases even required) to acquire an interest in the target to ensure management's commitment post-acquisition. Senior management is sometimes also given the opportunity to invest in the very same instrument (institutional strip) into which the private equity fund invests (on HoldCo level), which ensures that the interests of senior management and the interests of the private equity firm are fully aligned. Sometimes the incentive provides for a ratchet mechanism entitling management to an enhanced return once the investor's return passes a certain hurdle. Where management is asked to participate in the institutional strip, options are by definition limited (although ratchet arrangements and the like are still possible and quite common). Where asked (or given the opportunity) to acquire an interest on target level, the most common incentive packages comprise:

- (real) shares;
- share options (in the case of JSCs);
- profit participation rights (that is, a contractual arrangement that can be structured either as equity or debt and in contrast to shares never carries voting rights); and
- virtual shares (that is, a contractual arrangement giving the member a share-like return upon exit).

The detailed structuring of the incentive packages is dependent on the tax treatment of the benefits in the relevant jurisdictions. For example, management will have a strong interest that:

- there is no taxation at the time of grant (see below); and
- exit proceeds are taxed as capital gain and not as employment income.

Real shares are usually pooled and almost always subject to a restricted stock agreement or shareholders' agreement providing for a drag-along right of the private equity firm and compulsory transfer provisions if the employment with the target group is terminated. The consideration due in the case of such compulsory transfer will often depend on the reason for termination (good and bad leaver provisions); although because of associated employment law issues and increased scrutiny on unfair dealings, the approach taken by private equity firms is much more conservative today than in the more recent past.

Law stated - 15 Februar 2024

Tax issues

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

Financing of an Austrian acquisition vehicle

Equity financing

Effective since 1 January 2016, capital duty to the amount of 1 per cent on equity funding was abolished and, according to EU law, cannot be reintroduced. This has simplified funding as multilayer structures (grandparent contributions) are no longer necessary to avoid capital duty on equity funding.

Debt financing

Debt-financed acquisitions are usually structured to allow interest deduction as well as an offset from the profits of the target company. Interest paid on loans from unrelated parties is generally fully tax deductible. Interest on related party loans is only tax deductible if the following criteria are met:

- the terms are at arm’s length and properly documented;
- the debt is not requalified as equity;
- there is no low taxation of group lenders; and
- the interest barrier rule does not apply.

With regard to the arm's-length test, the Austrian tax authorities generally apply the comparable uncontrolled price method. However, a comparison of inter-company financing transactions to those with commercial banks is generally not accepted by the Austrian tax authorities (because of different objectives and goals of an unrelated lender, as well as the different risk profile). As a result, the interest rates of banks can only be considered as the upper limit of the arm's-length interest rate. In general, in determining the interest rate, factors such as currency, term, the creditworthiness of the borrower and refinancing costs need to be taken into account. In any event, proper documentation is essential to evidence that the arm's length test is met.

As to the requalification of debt into equity, it is worth noting that there are no statutory rules on thin capitalisation in Austria. In practice, tax authorities accept debt-to-equity ratios of 3:1 to 4:1. Beyond that, interest deduction may be denied based on a requalification of shareholder loans into equity. Besides the non-deductibility of interest from the tax base, this would also mean that any interest payments made are treated as hidden dividends, which – unlike interest on shareholder loans – would be subject to withholding tax in Austria.

Interest payments under a loan from a foreign-related party lender are not deductible in Austria if the interest payments are not taxed at an effective tax rate of at least 10 per cent at the level of the foreign-related party lender. According to the Austrian tax authorities, it is not relevant whether such low taxation is owing to the domestic law of the jurisdiction of the lender or the result of an applicable double taxation agreement (DTA).

Effective since 1 January 2021, Austria has introduced an interest barrier rule implementing the Anti Tax Avoidance Directive. As a result, an interest surplus (interest expenses that surpass interest earnings) is only tax deductible up to 30 per cent of the tax earnings before interest, taxes, depreciation and amortisation (EBITDA). However, an exception is made for stand-alone companies, which are not included in a group’s consolidated financial statements and have no associated enterprise or foreign permanent establishment. Generally, per assessment period, an interest surplus up to €3 million is always deductible (tax-free amount). If the equity ratio of the company is similar to the average group equity ratio, interest surplus can be deducted without restriction. Interest surplus and EBITDA surplus can be carried forward without limitation.

Austrian group taxation regime

The use of an Austrian acquisition vehicle allows for the establishment of a tax group between the acquisition vehicle and the target. Such tax group allows for the offsetting of interest expenses at the level of the acquisition vehicle from the business profits of the target. Non-Austrian companies may also be part of an Austrian tax group. However, the group taxation regime aims to limit the inclusion of non-Austrian companies (to corporations resident in EU member states or other countries with which Austria has concluded comprehensive administrative assistance procedures) and the attribution of their losses (which can only be offset by up to 75 per cent of the taxable income, with the balance being carried forward to future years). For tax groups, the above-mentioned principles regarding the interest barrier rule are applied at tax group parent level. As a result, a group interest surplus (interest expenses that surpass interest earnings), is only tax deductible up to an amount that equals 30 per cent of the tax group EBITDA. Generally, per assessment period and tax group, an interest surplus up to €3 million is always deductible (group tax-free amount). If the tax group exists within a larger group (from a corporate law perspective) and the equity ratio of the tax group is similar to the average group equity ratio, interest surpluses can be deducted without restriction.

Withholding tax

Dividends and interest payments are generally subject to withholding tax of 27.5 per cent (24 per cent from 2023 if received by corporations). However, limitations and exemptions apply under domestic law as well as applicable DTAs. In particular, withholding tax on dividend payments to non-Austrian investors is typically subject to the limitations under Directive 2011/96/EU (Parent-Subsidiary Directive) and applicable DTAs. Interest payments on loans to non-Austrian lenders are no longer subject to withholding tax, since withholding tax on interest payments under loans secured by Austrian real estate has been abolished.

Taxation at exit

Private equity investors will usually seek a structure that allows for a tax-efficient exit. As there is no tax exemption for capital gains realised from the sale of shares in an Austrian company (as opposed to shares in a foreign company), foreign investors tend to choose an acquisition vehicle in a foreign jurisdiction that has concluded a favourable DTA with Austria providing that only such other jurisdiction is entitled to tax capitals gains.

Austrian tax law provides for a sophisticated exit taxation regime under which capital gains taxation is – simplified – triggered under any circumstances that result in Austria's taxation right being restricted with respect to assets subject to taxation in Austria. If such taxation right is restricted in relation to EU or EEA countries, the taxpayer may apply for payment of the exit tax in instalments over a period of up to five years (unless the capital gain is triggered beforehand).

Real estate

For real estate deals, a tax reform (applicable since 1 January 2016) brought significant changes for companies owning Austrian real estate directly. First, the taxable event, 'unification of shares', that once required a unification of all shares in a company that directly owns Austrian real estate by one shareholder, now foresees a lower threshold of 95 per cent. Further, shares held by trustees are now attributed to the trustor in determining whether this threshold is met. Second, if, within five years in total 95 per cent or more in a partnership that directly owns real estate are transferred (also if in different transactions and to different purchasers), real estate transfer tax is now also triggered.

Management incentive packages

Taxation at grant

To ensure capital gains taxation of shares at the time of the exit, it is important that economic ownership actually transfers at the time of the grant, which mainly depends on the management members' rights to dividends, voting rights and the applicable transfer restrictions. In the case of economic ownership transfers where the management members receive the shares without paying arm's-length consideration, the grant will be taxed as employment income at the fair market value of the shares received. In the case where economic ownership does not transfer, the exit proceeds may be taxed as employment income at the time of exit on the basis that economic ownership only transfers at the time of the exit. Non-transferable share options are not taxed at the time of the grant, but upon exercise of the option based on the difference between the (discounted) acquisition cost and the fair market value of the shares received upon their exercise. In contrast, transferable share options are considered an asset for tax purposes and, consequently, are already taxed at the time of the grant. With respect to profit participation rights, similar considerations apply as for the taxation of the grant of (real) shares.

Taxation at exit

Dividends and capital gains from (real) shares received by resident individuals is taxed at 27.5 per cent. Former models involving real shares relied on an exemption for capital gains (if the percentage of the shareholding in the Austrian company was below 1 per cent and was held for more than one year), which are no longer applicable as capital gains are now generally subject to taxation. However, in the case of non-resident individuals, capital gains are only subject to taxation in Austria at a rate of 27.5 per cent if the percentage of the employee’s (weighted) shareholding in the Austrian company amounts to at least 1 per cent during the last five years. DTAs usually restrict Austria’s right to tax such capital gains (article 13, paragraph 5 of the Organisation for Economic Co-operation and Development Model Tax Convention on Income and on Capital), whereas dividends are subject to withholding tax at a rate of 27.5 per cent (which is usually reduced by DTAs).

Income from profit participation rights that classify as equity at the level of the company is taxed similar to dividends at a rate of 27.5 per cent. If, owing to its features, profit participation rights qualify as debt at the level of the company, income is either taxed similar to interest at a rate of 27.5 per cent or at the progressive income tax rate up to 55 per cent, depending on whether there has been a public placement. Regarding exit structuring, profit participation rights generally provide more room for tax-optimisation than other incentive packages, such as (real) shares or share options.

Income from virtual shares (not qualifying as profit participation rights) is generally taxed as employment income.

Law stated - 15 Februar 2024

DEBT FINANCING

Debt financing structures

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

Financing structures

Senior debt is the highest ranking layer of debt in a leveraged buyout. It usually comprises one or more term loan facilities and a revolving facility. Private equity firms have increasingly preferred bullet repayment profiles over amortising profiles while trying to keep prepayment costs as low as possible. The security package for the senior debt includes security at the buyer level and, from completion, from the target group based on agreed security principles. Senior debt is sometimes supplemented by junior debt (which ranks pari passu with senior debt except that senior debt ranks ahead of junior debt with regard to the proceeds of security enforcement and has a higher margin) or mezzanine debt (which ranks after senior debt, is secured on a second ranking basis and usually provides for payment-in-kind interest or warrants). Compared to senior debt, covenant baskets and financial covenants typically provide for more headroom.

More recently, specialist debt funds have tried to get involved. In a debt funds structure the debt fund would provide the term loan to the buyer (to finance the acquisition and the costs of the acquisition) and the commercial bank the working capital facilities (to fund the working capital requirements of the target group). Sometimes the debt funds also underwrite the entire financing package with a commercial bank in the background that provides the working capital facility. The term loans are often structured as a unitranche facility (which is a single-bullet repayment facility combining the risk profile of senior and junior debt at a blended interest rate). Unlike traditional senior debt, the prepayment of a unitranche facility typically usually triggers an obligation to pay a make-whole amount or a prepayment premium. The term loans usually rank junior to the revolving facility loans with regard to the proceeds of security enforcement.

Vendor financing is also sometimes used, but lately this is not very frequent. To meet ‘certain funds’ requirements in private equity transactions involving a takeover bid, bridge financing is often required, which more frequently comes from debt funds as they have quicker turnaround times than commercial banks. Where several layers of debt are involved, the private equity firm and financing banks will typically enter into an intercreditor agreement that regulates the rights of each layer of debt to receive payment and to the proceeds of security enforcement in the case of an enforcement event.

Existing financing

The terms of the existing indebtedness often require prepayment upon a change of control and typically contain limits on additional leverage or dividend stoppers that will require a refinancing or renegotiation of the existing indebtedness. More often, existing indebtedness is prepaid, in which case prepayment notice requirements, prepayment fees, breakage costs and security releases will have to be considered by the private equity firm in the overall timing of the transaction.

Financial assistance

Leveraged transactions typically involve upstream and sidestream security interests, guarantees and indemnities by the target group that are a concern under Austrian capital maintenance and, where a joint-stock company is involved, Austrian financial assistance rules. Transactions violating Austrian capital maintenance rules are null and void as between the parties as well as any financing provider that knew or should have known of the violation. Members of the management or supervisory board who approved the transaction may be subject to liability for damages. Transactions violating Austrian financial assistance rules are not void, but may result in liability of the members of the management or supervisory board who approved the transaction. It is widely accepted to include limitation language in the financing documents to prevent liability and ensure that security interests and guarantees remain valid in part to preserve priority.

Law stated - 15 Februar 2024

Debt and equity financing provisions

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

Certain funds

Under the Takeover Act, a bidder may only announce a takeover bid if it is certain that the funds necessary to pay the consideration in full are available (certain funds requirement); this must be confirmed in the opinion on the takeover bid of an independent expert. Consequently, debt and equity financing must be very advanced when a takeover bid is announced. Unless a financing condition has been permitted by the Takeover Commission (which could be the case in a voluntary takeover bid not aimed at control), the independent expert will usually require a copy of the executed equity commitment letter from the private equity fund. Where the equity commitment letter only covers the equity portion of the offer price, the independent expert will also want to see copies of the definitive financing documents documenting the term loan facilities financing the debt component of the offer price (mentioned earlier), together with documents evidencing that all conditions precedent for the drawdown of those facilities (other than those within the private equity firm's sole control) are satisfied.

Block sale

Where a purchase agreement with one or more block shareholders is involved in a going-private transaction, the purchase agreement will typically include a condition that the acquisition vehicle will acquire the necessary number of shares in the takeover, so that it is able to proceed with the squeeze-out (90 per cent threshold) or the delisting (75 per cent threshold) as per the funds further intentions. The seller under that purchase agreement will usually require a copy of the equity commitment letter from the private equity firm and copies of the definitive agreements documenting the term loan facilities (or at least a warranty that enforceable debt financing commitments have been obtained and obligations to ensure that definitive agreements will be in place by closing, failing which the purchaser will usually be required to pay the termination costs) to be sure that the acquisition vehicle will be able to pay the purchase price at completion of the transaction.

Law stated - 15 Februar 2024

Fraudulent conveyance and other bankruptcy issues

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

Contestation

Under Austrian insolvency law, when an Austrian company has entered insolvency proceedings the administrator may challenge certain transactions if this increases the prospects of recovery for the estate’s creditors, most notably:

- transactions intended to discriminate against other creditors (if completed 10 years or less prior to the opening of the insolvency proceedings (if the counterparty was aware of that intent) or two years (if the counterparty should have been aware of that intent));
- transactions for no value (if completed two years or less prior to the opening of insolvency proceedings); or
- the granting of security benefitting a creditor’s debt or the settlement of a creditor’s debt (if completed 60 days or less prior to the company becoming insolvent or the application for the opening of insolvency proceedings).

In leveraged transactions, there is a concern that security interests and guarantees can be set aside on such grounds. For that reason, purchase and debt financing agreements typically include warranties that no insolvency proceedings are pending and that neither the target nor the seller is insolvent. Where, in a particular transaction, there is a concern regarding insolvency, the private equity firm will typically require additional evidence, such as an officer's certificate from the chief financial officer or a special audit opinion, or both, to be comfortable that there are no insolvency related issues. In addition, actions taken with the intention to deprive other creditors of their rights may constitute a criminal offence.

Financial assistance

In addition, an administrator may seek to set aside upstream or sidestream security interests, guarantees, indemnities or similar commitments on the basis that they constitute a violation of Austrian capital maintenance or financial assistance rules as well as embezzlement (if certain additional requirements are met) and an administrator may try to bring claims against members of the management board and supervisory board who approved such transactions. As mentioned above, it is widely accepted practice to address these concerns in the financing documents by appropriate 'limitation language'.

Law stated - 15 Februar 2024

SHAREHOLDERS' AGREEMENTS

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

Typical provisions

Shareholders' agreements for a minority investment or a club deal involving investments made by two or more private equity firms or other equity co-investors will typically include provisions dealing with the following matters:

- composition of the management, supervisory or advisory board (if any);
- rights to nominate members or observers, or both, to the management, supervisory or advisory board (if any);
- veto rights requiring the prior consent of the supervisory or advisory board (if any) or the shareholders meeting with a qualified majority and the consent of the investor;
- pro rata subscription right (except for rescue financings);
- exit provisions:
  - exit rights (right of investor to trigger and control a trade sale or initial public offering);
  - waterfall (preference of the investor with regard to exit proceeds up to certain hurdle);
  - ratchets (reallocation of pro rata allocation to the founders once the investor has passed a certain hurdle);
- restrictions on dealing with shares:

    - prohibition to sell (lock up) shares for a certain minimum period (which may apply to all or only some of the shareholders, for example, the founders only, and may differ in length from shareholder to shareholder);
    - rights of first refusal, drag-along, tag-along and similar rights (eg, upper level sale drag-along right);
- requirements for management and annual accounts, business plan and budget;
- access to information and management upon request; and
- exclusivity and covenants not to compete and not to solicit customers, suppliers and employees.

Statutory protection

Statutory protection for minority shareholders differs. For corporations, minority shareholder protection includes information rights, rights to call a shareholders' meeting and minimum voting requirements for major measures (eg, corporate restructurings, changes of purpose, changes to articles of association, dealings involving substantially all of the business or assets and squeeze-out transactions). Some of these protections are mandatory, others may only be adjusted to the benefit of the minority shareholders and others can be amended in the articles of association without restriction.

Law stated - 15 Februar 2024

ACQUISITION AND EXIT

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

Private companies

Apart from clearance and notification requirements which apply to control acquisitions generally, investors who are subject to the Alternative Investment Fund Managers Directive and its subordinate legislation are subject to certain additional obligations when acquiring a controlling interest in a non-listed company, most notably:

- the obligation to provide certain information to the target company, its shareholders and the body regulating the alternative investment manager (AIFM) and to require management of the target company to pass on such information to employee representative bodies (if existing) or the employees directly (if not existing) on:
    - the AIFM managing the alternative investment fund acquiring control;
    - the principles applied to avoid conflicts of interest;
    - the communication policy with regard to the target company; and
    -

the intentions with regard to the future business and impact on employees; and

- the obligation to refrain from asset stripping (essentially excessive capital drain and capital reductions) for a period of 24 months from closing of the control acquisition.

Public companies

The acquisition of a controlling interest in a listed company must be notified to the Takeover Commission without delay and triggers a mandatory takeover bid for the remaining shares that must be launched within 20 trading days. The mandatory takeover is subject to, among other things, minimum pricing requirements, as follows:

- the consideration must not be lower than the highest price agreed or paid in the 12-month period before the announcement of the takeover bid; and
- the consideration must at least equal the average quoted share price (weighted according to trading volumes) in the six-month period before the day on which the intention to launch the takeover bid is announced).

The Takeover Act captures direct controlling interests (ie, where more than 30 per cent of the voting rights in a listed target company are directly held by a bidder) and indirect controlling interests (ie, where more than 30 per cent of the voting rights in a listed target company are held by the bidder through another listed company in which the bidder holds more than 30 per cent of the voting rights or an unlisted company (or other entity) over which the bidder can exercise control). There is, however, an exception where:

- the interest acquired by the bidder cannot confer control on the bidder (eg, because another shareholder has as many or more voting rights, because of the usual representation at shareholders' meetings the interest acquired does not confer a majority of voting rights or the voting rights are limited to 30 per cent by operation of the articles of the target company); or
- the bidder already had control, the bidder is only required to notify the Takeover Commission without delay and in any event within 20 trading days, but there is no obligation to launch a mandatory bid. Target companies may lower the 30 per cent threshold through a provision in their articles of association and several companies have done so in response to takeover bids.

In addition, an acquisition of a direct or indirect interest conferring more than 26 per cent but not more than 30 per cent of the voting rights of a listed company must be notified to the Takeover Commission without delay and in any event within 20 trading days; the voting rights exceeding 26 per cent are suspended (unless another shareholder has as many or more voting rights, the voting rights of the bidder are limited to 26 per cent by operation of the articles of the target company or the bidder already had such voting rights), but there is no obligation to launch a mandatory bid for the remaining shares.

Law stated - 15 Februar 2024

Exit strategies

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

A private equity seller will generally seek to retain flexibility in its ability to liquidate its investment, which may include having the right to request an initial public offering (IPO) or a trade sale after a minimum holding period (usually not exceeding five years) and the right to drag along other shareholders in the event of a sale by the private equity firm of all or a significant portion of its shares. Both exit rights and drag-along rights are usually subject to certain restrictions (eg, a pre-emption or a tag-along right or a minimum return requirement on the drag-along right), which may affect the private equity firm's ability to sell.

Private equity sellers are usually not prepared to accept substantial continuing liability to purchasers and generally only accept obligations within their control, such as to transfer the shares, limited warranties on title and capacity, a leakage covenant and an obligation to conduct the business in the ordinary course pending completion of the transaction. A private equity seller will usually not agree to give business warranties, a tax indemnity or specific indemnities. Private equity sellers will also try to limit recourse (eg, to a purchase price holdback, an escrow amount or the amount insured under warranty and indemnity insurance (W&I)). In auctions, private equity sellers often arrange buyside W&I (flipping policy) as part of the transaction, or it is made clear that the purchaser is expected to have non-recourse W&I in place at signing. Private equity sellers will normally also not be willing to give restrictive covenants, such as non-compete or non-solicit undertakings.

On an IPO, the portfolio company will have to satisfy the listing requirements of the relevant stock exchange. The shareholders agreement usually does not provide for detailed registration rights (which may limit the percentage the private equity firm can sell into the IPO) or lock-up restrictions (which may limit the ability of the private equity firm to sell any shares retained following the IPO) but provide for detailed provisions on process which allow the private equity seller to appoint all relevant advisors, lead all negotiations and discussions and have very firm control over the entire process.

Law stated - 15 Februar 2024

Portfolio company IPOs

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

An IPO as such does not invalidate rights or restrictions agreed between the shareholders per se, but the shareholders' agreement usually provides that an IPO constitutes an exit and results in the termination of the shareholders' agreement.

In an IPO, the underwriting banks will usually require that part of the existing shares retained following the IPO be locked up for a period of 12 to 18 months. They will not, however, discuss who may sell into the IPO. Some shareholders' agreements therefore provide that lock-up periods agreed at the time of the IPO must apply equally to all shareholders.

Law stated - 15 Februar 2024

Target companies and industries

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

There have only been a handful of completed going-private transactions in recent years, which makes it difficult to identify typical target industries. The difference of a going-private transaction compared to other transactions from a private equity firm’s perspective is additional complexity and additional transaction costs because of the minimum pricing requirements under the Takeover Act and potential minority shareholder resistance, in particular where there is a significant free float.

Transactions involving a change of control of targets in regulated industries may be subject to advance notice or approval requirements, or both, which may affect timing. That applies equally to going-private transactions and other transactions.

Law stated - 15 Februar 2024

SPECIAL ISSUES

Cross-border transactions

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

Regulated industries

In regulated industries (eg, banking, insurance, utilities, gambling, telecoms or aviation) the acquisition of a qualified or a controlling interest is typically subject to advance notification or approval. Sanctions range from monetary penalties, to a suspension of voting rights, or a partial or total shutdown of the business.

Real estate

The acquisition of ownership and certain other interests in real estate by non-EEA nationals or the acquisition of control over companies owning such interests is subject to notification to or approval by the local Real Estate Transfer Commission (depending on the relevant federal state). What interests are covered and whether notification or approval is required varies across Austria from federal state to federal state. Where the real estate is used for commercial rather than residential purposes approvals are usually granted.

Investment Control Act

Part 1 and Part 2 of the Annex to the Austrian Investment Control Act (ICA) list economic sectors in which foreign direct investments by a foreign investor (being, an individual that is not a citizen of an EU or EEA country or Switzerland or entity having its seat or head office outside the EU, EEA or Switzerland) – above certain quantitative and qualitative thresholds – must be notified to the Ministry for Digitalisation and Economic Affairs immediately following the signing on the basis that these sectors are considered relevant to public security and public order (including crisis management and services of general interest). In the case of concerns, the investment can be prohibited or requirements and conditions can be imposed. Implementation without the approval of a transaction requiring ICA approval constitutes a criminal offence with a penalty of imprisonment of up to a maximum of one year (and up to three years in the case of certain qualified offences). The same penalties apply if incorrect or misleading information is supplied.

Law stated - 15 Februar 2024

Club and group deals

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

Austrian law does not restrict multiple private equity firms, or a private equity firm and a strategic partner to participate in a club or group deal. However, a club or group deal may raise antitrust concerns and trigger additional competition clearance requirements. In addition, where the transaction involves a listed company, the partners in such deal will usually be considered to ‘act in concert’, and as such any shares held or acquired by them will be aggregated for determining the various thresholds under the Takeover Act and the Stock Exchange Act.

As a practical matter, club and group deals tend to add another layer of complexity, in particular, where the partners in a club or group deal have different objectives (eg, a private equity firm usually has a different investment horizon and investment objective compared to a strategic investor) and structuring requirements that must be accounted for in the structuring of the transaction and the shareholders’ agreement and ancillary documentation (eg, by introducing a special exit right or a liquidation preference for the private equity firm or a buyout option or special governance rights for the strategic partner where the strategic partner shall have control over the business and the private equity firm shall hold a purely financial interest).

Law stated - 15 Februar 2024

Issues related to certainty of closing

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

Austrian sellers have been generally successful in resisting closing conditions other than in relation to antitrust clearance or other regulatory approvals, material third-party consents and completion of agreed pre-closing restructurings. Sometimes, material adverse change (MAC) conditions have been accepted were required by a private equity purchaser to mirror a material adverse change condition in a debt commitment letter (but this is rather the exception) or were limited to adverse changes to the business (business MAC). Warranties being true and correct or pre-completion covenants having been satisfied (which is relatively standard in the United States) were the exception and only discussed where US investors were involved.

Law stated - 15 Februar 2024

UPDATE AND TRENDS

Key developments of the past year

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

Private equity transactions and deals saw a strong decline in 2023, only marginally beating the low of 2020, with the transactional value plummeting by 26.5 per cent in Europe. Austria was no exception. Activity slowed downed generally across segments but new venture capital investments were particularly rare. There were a few larger buyout transactions but in general the buyout segment was relatively mute compared to previous years as several auctions suffered significant delays or were pushed to 2024.

Law stated - 15 Februar 2024