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Private Equity 2022

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Austria: Law & Practice

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AUSTRIA

Law and Practice

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1. Transaction Activity

1.1 M&A Transactions and Deals

Private equity M&A deals reached record levels in Austria in 2021. However, inflation, taxes, the war in Ukraine and the upcoming energy crisis put a damper on these highs, so the private equity market had a relatively slow start in 2022.

Activity in the private equity sector itself is divided in view of the above threats. What was once a seller-friendly market is meeting with critical and hesitant investors in 2022, so that companies are no longer in a bidding process but have to fight hard for investors. The other side sees precisely these developments as an opportunity for the private equity sector, with investments in the digitalisation, technology, healthcare and sustainability sectors, including green energy, being particularly attractive.

2022 is expected to see continued interest in sustainability-oriented investments, with investors demanding data on the environmental, social and governance (ESG) standards of target companies before they decide to invest. Transparent co-operation and detailed disclosure continue to be key to a good investment for both sides in Austria.

1.2 Market Activity

Market activity in Austria remains quite diversified in 2022, with the sustainability (including green energy), technology, digitalisation and healthcare sectors being particularly active. The technology sector has strengthened enormously, particularly because of the COVID-19 crisis, and green energy is picking up in view of the gas (energy) crisis in Europe related to the Russian sanctions due to the war in Ukraine. Generally speaking, the private equity sector still needs to catch up in Austria in terms of both investment size and number of deals compared to other EU Member States. The economy is largely dependent on debt financing and family businesses, which often still avoid the influence of private equity investors and continue to dominate the corporate sector.

Private equity companies are also focusing on the development of their own digitalisation, which is not only useful for possible due diligence work in target companies, but also for keeping an eye on and analysing their own portfolio companies in Austria.

2. Private Equity Developments

2.1 Impact on Funds and Transactions

Important legal developments are taking place at the European level, which have an impact on private equity transactions. The EU has outlined sustainability factors in a “Sustainable Finance Framework” and issued legal frameworks, as the interest in sustainability-oriented investments has increased enormously among investors.

Sustainability Reporting

In April 2021, the European Commission published a draft revision of the Non-Financial Reporting Directive and the Corporate Sustainability Reporting Directive (CSRD), the scope of which is to be extended so that all large companies and all companies listed on a regulated market are covered. The intention is to close gaps in the existing regulations on ESG information.

Sustainability reporting has to be subject to mandatory auditing, detailed and standardised requirements have to be set for the disclosure obligations of companies and, in general, access to information has to be improved. The informa-

tion must be published in the European Single Electronic Format no later than one year after the balance sheet date. For small and medium-sized companies, a simplified reporting standard is to be introduced from 21 October 2023. The deadline for the adoption of the standards (both general and sector-specific to SMEs) by the Commission is 31 October 2022.

Climate Change

The fight against climate change will also continue in the private equity industry. The EU has adopted the Sustainable Finance Disclosure Regulation (SFDR), which aims to pursue the EU's policy goals of zero greenwashing and improving products to become more sustainable. The regulation applies to developers and providers of financial products, financial advisers and the products they offer. Based on the SFDR, the players have to classify their products into different categories, which subsequently leads to better comparability of the products with regard to sustainability factors, which are included in the decision-making process. The SFDR was adopted in 2019, and the disclosure requirements will be phased in from 2021 to 2023. Stage one has applied since 2021 and stage two since 1 July 2022. Since 1 July 2022, the classification of private equity funds under the relevant articles shall combine the documentation of the impact of the investment strategy with regard to ESG criteria.

Alternative Investment Fund Managers Act (AIFMG)

No less significant was the introduction of the AIFMG in the EU, which was recently renewed (published on 10 December 2021 in the *Bundesgesetzblatt für die Republik Österreich*), regarding sustainability-related disclosures for reference values. The modifications primarily incorporate into Austrian law the EU pre-marketing requirements concerning facilitations for cross-border fund distribution. Potential professional investors (pre-marketing is inadmissible in the private investor sector) are to receive comprehensive information, which may not be subscription forms or similar documents in draft or final form. The requirements for pre-marketing apply mutatis mutandis to an alternative investment fund manager authorised in another EU Member State.

Austria also demands its own venture capital fund law, which should create new, attractive possibilities for entrepreneurs to take advantage of equity financing as an alternative to debt financing. A legal framework for equity financing does not yet exist, although the private equity community continues to ask for it.

3. Regulatory Framework

3.1 Primary Regulators and Regulatory Issues

The private equity industry is complex and the amounts invested are substantial, so there is a need for appropriate protection for both the investors and the target companies. Legislators have enacted a number of regulations and directives at the European level, which Austria has transposed into national law to regulate and supervise transactions.

The relevant supervisory authorities in Austria are the Financial Markets Authority (FMA), the Federal Competition Authority (BWB), the Federal Ministry for Digitalisation and the Takeover Commission (UeK). On a European level, the authorities are the European Systemic Risk Board (ESRB), the European System of Financial Supervisors (EBA, EIOPA, ESMA), the Single

Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM).

The AIFM Directive and National Implementation

The legal framework for alternative investment funds (AIFs) introduced specific regulations aimed at the private equity business model, providing special notification, disclosure and reporting obligations for private equity funds or their managers. The Directive also prohibits such funds from taking a series of capital measures within 24 months of acquiring a holding or control that could endanger the existence of the portfolio companies (breaking up companies). Austria implemented the directive in the form of the AIFMG. Due to the very general definition of AIFs, the scope of application of the AIFMG was extended, but has not been conclusively clarified. Austria's AIFs largely fall under the exception of "small" AIFS and are therefore subject to reduced supervision. In particular, they do not need a licence, but only a registration with the FMA. Furthermore, they are not allowed to sell their units to private clients.

Investment Control

The Austrian Investment Control Act (InvKG) provides for control of the acquisition of Austrian companies by a foreign (ie, non-EU) investor. Such acquisitions are subject to approval under certain conditions according to Section 2 of the InvKG if the Austrian target company is active in a security-relevant sector or a sector that is relevant to the public, and one of the following is to be acquired:

- the entire Austrian company or a certain share of its voting rights (the threshold is 10% for target companies operating in particularly sensitive sectors, and 25% or 50% in all other cases);
- a controlling influence in that company; or
- a significant asset of that company.

Micro-enterprises, including start-ups, are exempt from filing if they have fewer than ten employees and an annual turnover or balance sheet total of less than EUR2 million. If the authorisation is not obtained, the transaction may still be valid if the authorisation is subsequently granted. A direct investment is especially examined to determine whether the transaction may lead to a threat to security or public order in Austria, including crisis management and public services, and whether such a threat is to be feared.

Antitrust Regulation

Acquisitions of companies or shares can constitute a merger within the meaning of Austrian or European merger control and must be notified. Each of the following events forms a concentration within the meaning of Section 7 of the Austrian Merger Control Act (KartG):

- the acquisition of the entire enterprise, or a substantial part of the enterprise (ie, merger or transformation);
- the direct or indirect acquisition of shares in a company that is an entrepreneur by another entrepreneur, if 25% or 50% or even more of the shares are acquired;
- the combination of undertakings by virtue of which an entrepreneur may directly or indirectly exercise a dominant influence over another undertaking; or
- the formation of a joint venture.

Such a merger then requires notification in Austria prior to its completion pursuant to Section 9 of the KartG when any of the following occur:

- a total worldwide turnover of more than EUR300 million is surpassed;
- a total turnover in Austria of more than EUR30 million is surpassed, of which at least two companies each have a turnover of more than EUR1 million (the second sub-sentence was newly introduced); and
- at least two companies worldwide each generate more than EUR5 million in the last business year.

Mergers are exempt from the obligation to notify if only one of the participating enterprises has achieved a turnover of more than EUR5 million in Austria and the other participating enterprises have not achieved a turnover of more than EUR30 million worldwide.

The most important change affecting the private equity sector is the addition of a second domestic turnover threshold of (only) EUR1 million for the obligation to notify mergers in Austria. Furthermore, the criterion of significant impairment of effective competition (SIEC) was introduced into merger control.

Concentrations of EU-wide significance must be notified to the European Commission, particularly if:

- a turnover of more than EUR5 billion was generated worldwide (of all participating companies in total); and
- at least two participating undertakings have achieved more than EUR250 million each throughout the EU (EU-wide significance due to absolute size).

EU-wide significance is not attained if the participating companies have each achieved more than two thirds of the total EU-wide turnover in the same Member State. If the obligation to notify is not complied with, high fines may be imposed.

Finally, ESG compliance and the fight against bribery and corruption must be taken into consideration. Anti-bribery and corruption compliance is a prerequisite for ESG reporting. The tech, media and telecom sectors in particular are often victims of cybercrime. Moreover, investment companies are well advised to take out insurance for M&A processes to also cover damages resulting from fraud, bribery and corruption. Bribery and corruption are criminal offences under the Austrian Criminal Code (StGB).

4. Due Diligence

4.1 General Information

Legal due diligence has evolved to red-flag due diligence only, based on a full-scope exercise conducted solely via virtual data rooms. Commonly, the virtual data room is divided and only certain clean team members receive access to the competitively sensitive information. The due diligence is usually conducted within three to four weeks but the period is frequently shortened to one or two weeks.

Legal due diligence in a private equity transaction focuses on title, corporate history, essential contracts (in particular but not limited to change of control clauses and exclusive agreements), compliance and regulatory matters, employment, IP and IT, financings, litigation, environment, insurance and real estate matters.

4.2 Vendor Due Diligence

Vendor due diligence – or fact books – is common among private equity sellers because it provides them with initial knowledge, control over information dissemination, and the opportunity

to identify, address and comment on risk areas before a buyer addresses them in the due diligence process. In addition, vendor due diligence can provide potential buyers with a comprehensive picture of the business and highlight any interdependencies and synergies between the strategic, commercial and technical operations and organisational capabilities, so that multiple high-quality bids can be submitted in an auction process.

Typically, the advisers request the signing of a non-reliance letter before the private equity seller may disclose such fact book to the buyer or its respective advisers. Thus, the adviser shall not be held liable for the accuracy of the fact book by the buyer.

Also, the advisers on the buy-side due diligence typically request the signing of a non-reliance letter before the buyer may disclose such report to the financing bank or the warranty and indemnity (W&I) insurance provider.

5. Structure of Transactions

5.1 Structure of the Acquisition

Acquisitions of Austrian targets by private equity funds typically take the structure of a privately negotiated treaty sale or an auction process. The method is determined by the seller and often depends on the standing of the seller/target and negotiation position of the parties: sellers will usually seek an auction process in order to maximise their return on the market, but also factor in closing certainty. Recently, there has been a market tendency in favour of sellers in M&A transactions (subject to industry), which added to the frequency of auction processes initiated by sellers. The parties typically employ investment banks and professional advisers to handle the process, which is regularly governed by a process letter that can be freely determined by the selling private equity fund.

In addition, transaction speed in general, and transaction certainty in particular, have increasingly become the most common features of private equity transactions. However, in cases of smaller deal volumes or financially less sound or attractive targets, or targets with high innovation potential but less apparent business prospects (eg, start-ups), specialised private equity partners experienced in growth funding or turnaround scenarios will often be approached privately, in a bid to avoid market attention. Court-approved acquisition schemes are more rare, although in cases of targets in a financial crisis, sellers/targets are occasionally willing to pre-align a court-supervised reorganisation under which the administrator sells the enterprise and the private equity investor tries to make the most attractive bid, subject to approval by the creditors' committee and the court.

Special rules apply for acquisitions or disposals of shares in listed entities, which are governed by takeover and securities regulation and need to follow a rigid scheme of conditions, formalities and timelines predetermined by regulatory law and supervised by the Austrian Takeover Commission.

5.2 Structure of the Buyer

The structure of the entity acquiring a stake in the target depends on various factors, mostly driven by tax, acquisition financing, ring-fencing (ie, creating a liability shield) and exit-related considerations. Internationally active private equity funds often set up multiple layers of intermediary companies through various jurisdictions that are regarded as being tax beneficial, with an Austrian NewCo (AcquiCo) at the bottom end.

In most cases, such AcquiCo takes the form of an Austrian (shelf) company with limited liability (GmbH), which is the most common type of company used in Austria.

Besides the external advisers of the private equity fund, the acquisition process will often be accompanied directly by managers of the fund manager or the fund's investment advisory vehicle, who will often take an active role in the structuring of the purchasing entities, the acquisition, and the determination and negotiation of the key terms thereof.

5.3 Funding Structure of Private Equity Transactions

Private equity deals usually apply a combination of equity and debt financing, often highly leveraged but seeking compliance with tax requirements such as thin capitalisation rules. A rough rule of thumb seen in the past has been a debt:equity ratio of 80:20 (or 70:30). Debt financing may either be obtained directly by the Austrian AcquiCo and/or by one of the upstream entities, which would then either on-lend the funds via shareholder loans or seek to transfer external debt downstream by debt push-down. The forms of debt financing include:

- senior debt – heavily secured, first ranking collateral and typically rather rigid covenants;
- mezzanine debt – less or second ranking security, serviced only after senior debt and less rigid (more lenient) covenants, against higher interest rates; and
- junior debt – deeply subordinated without security, against relatively the highest interest rates, and only served if senior and mezzanine debt have been fully satisfied.

One of the most crucial considerations in these structures is to ensure compliance with Austrian capital maintenance and financial assistance rules, which are among the most rigid in Europe. Most notably, every transaction or disposal by a subsidiary (including the target) to the benefit of a direct or indirect parent or sister entity (including the buyer group) that is not made on arm's-length terms (including adequate consideration) typically violates capital maintenance rules.

The seller side typically requests evidence of the availability of funds, asking for equity commitment letters and/or commitment letters from financing banks. While purchasers may seek to submit softer forms of fund commitment letters, sellers increasingly scrutinise such letters to ensure they contain hard commitments, with a view to enjoying contractual certainty of funds from a private equity-backed buyer.

It is more common in Austrian practice for the private equity fund to acquire a majority stake in the target rather than a minority stake, but this may differ depending on the purpose and role of the private equity investor. In those cases where a private equity investor does not see a need to take control over management and business strategy to ensure profitable revenue streams and exit prospects (or in co-investment, business angel or management participation models – see **6.9 Warranty Protection**), minority stakes can be found, often combined with extensive shareholder agreements containing detailed rules on revenue waterfalls, hurdle rates and catch-up structures.

5.4 Multiple Investors

Deals involving a consortium of private equity sponsors have to some extent increased over the past ten years, bearing in mind that the private equity market in Austria is generally moderate compared to the larger EU jurisdictions. Such deals, sometimes referred to as "club

deals", involve consortia arranged between family offices and other investor groups, particularly private equity houses, in order to make joint investments. Most consortia have emerged in relation to the internet, e-commerce, innovative electronics and telecoms sectors. Despite increasing in numbers, club deals in Austria are still not frequent due to the lack of large deal sizes, although a desire for risk diversification is growing.

Structures frequently involve a main private equity investor accompanied by comparatively small(er) co-investors, including direct risk participations by fund management. All structures involving more than one or multiple investors require considerable and complex transaction structuring and drafting efforts. Sometimes they are implemented directly in relation to the respective targets but sometimes at a higher level (ie, at the level of the actual private equity funds and less on a target/AcquiCo level).

6. Terms of Acquisition Documentation

6.1 Types of Consideration Mechanisms

The three predominant forms of consideration structures found in private equity transactions are:

- locked-box;
- completion accounts/completion adjustment payments; and
- earn-out models.

In light of the market development, which has given sellers increased leverage, locked-box structures have become the most common form, particularly in auction processes, but completion account structures are frequently encountered as well. In contrast, earn-out models remain rare in the classical M&A world (and are typically rejected by sellers).

The involvement of a private equity fund (as opposed to other M&A players) on the buy-side does not necessarily affect the type of consideration mechanism used. Still, private equity funds recognise that locked-box models need to be combined with reasonable anti-leakage provisions (covering the period between the locked-box date and closing) and business conduct covenants (between signing and closing), although the willingness of private equity sellers to grant business representation and warranties (R&W) has diminished in favour of W&I insurance limiting recourse against a seller. As private equity funds do not typically have their cash calls to fund a transaction before closing, they tend to be less inclined to protect a seller through deposits or down-payments, other than by providing financing (equity/debt) commitment letters.

6.2 Locked-Box Consideration Structures

Locked-box consideration structures in Austria usually consist of a fixed purchase price. However, in the case of a leakage (often carefully defined, listing a certain catalogue of value drains in the share purchase agreement) – unless it qualifies as permitted leakage (ie, carefully defined exceptions to leakage) – that occurs between the locked-box date and closing, the seller has to compensate the buyer on a euro-for-euro basis.

Since the locked-box consideration is intended to reflect the economic status of the target upon the locked-box date (as the economic "cut-off" date) but is paid to the seller only at closing, sellers sometimes request that the considera-

tion bears interest from the locked-box date until closing. It may also be agreed that interest will be applied to leakage amounts (for the period between the occurrence of the leakage and its reimbursement to the target company or the buyer), but this is less commonly encountered in practice.

6.3 Dispute Resolution for Consideration Structures

It is standard in international private equity transactions to have a special expert dispute resolution mechanism in place for completion accounts consideration structures. It is less frequently encountered in locked-box structures (as regards leakage amounts) and/or earn-out models (as to whether the target benchmarks have been met), although they have the same merit and are recommended in those cases.

In the case of completion accounts, the parties agree on a review and objection mechanism by a neutral expert chosen by the parties or a similar institution. The auditor determines the purchase price according to a pre-agreed procedure, acting as an expert (*Schiedsgutachter*), although they are often also empowered to interpret the agreement, if necessary for the assessment. Their opinion is final and not subject to recourse. Dispute resolution under the share purchase agreement in general is often governed by a broad arbitration clause.

Expert determination procedures are sometimes also agreed in relation to whether and in what amount the company suffered any leakage between the locked-box date and completion, but the respective clauses are less frequently seen (possibly because parties tend to see leakage as something more straightforward to determine than in cases where more complex accounting issues are at stake).

6.4 Conditionality in Acquisition Documentation

Private equity sellers generally seek to limit conditions as much as possible, condensing them to the regulatory approvals that often cannot be avoided (such as merger clearance and/or foreign direct investment clearance, as applicable). In connection therewith, transaction certainty will be one factor that a private equity seller will take into account when selecting a preferred bidder to give a certain preference to bidders who do not face regulatory obstacles.

Instead, a private equity buyer will seek additional conditions precedent to protect the value of its investment, such as requiring consent by key business partners for any changes of control, keeping certain key employees, or the condition that no breach of R&W or covenants occurred prior to closing. The following observations are also relevant.

- Corporate approvals are sometimes requested as conditions precedent by larger corporate buyers but less so in the private equity world, where the private equity fund will often be able to seek internal approvals prior to signing.
- Change of control clauses in existing financing agreements with the target are often less of an issue if the PE investor seeks to refinance existing target debt.
- Obtaining financing by a buyer as a conditions precedent is regularly rejected by the sell side: sellers acknowledge that the funding of private equity funds for a specific acquisition often occurs only upon a cash call from the private equity investors shortly before or upon closing but are frequently looking to receive a strong equity (respectively financing) commitment letter to be handed in with a binding bid, in any event prior to signing.

- Private equity buyers are increasingly seeking material adverse change clauses, due to the fact that COVID-19 and other crises (eg, disruptions in delivery chains, the war in Ukraine and high inflation) are prompting prudent buyers to seek an exit possibility in case of unforeseen grave deteriorations of the business after signing.

6.5 "Hell or High Water" Undertakings

A "hell or high water" undertaking requires the buyer to undertake any and all actions and obligations necessary (often including divestiture) to satisfy governmental regulatory requirements. Private equity-backed buyers regularly accept undertakings for prompt filing and consultation with the sell side throughout the regulatory proceedings, but do not always readily accept undertakings to dispose of assets. If the undertaking goes so far as to oblige the private equity buyer to dispose of certain parts of the target, said buyer may feel more inclined to accept such commitment, provided it does not exceed certain value thresholds or core assets of the target that would make the deal economically unattractive. Then again, commitments obliging a private equity buyer to dispose of existing companies held in the fund's portfolio are usually a "no-go" for the fund and would often be non-compliant with the investment/divestment rules of the fund or other obligations towards its investors.

6.6 Break Fees

Break fees in favour of the seller are not widely seen in conditional deals with a private equity-backed buyer, as private equity deals are typically subject to a limited number of conditions, leaving limited room for contractual elements designed to reinforce deal security. The same applies to reverse break fees, which result in payment obligations in favour of the buyer.

When break fees are agreed, they are usually not triggered by the mere fact that a condition (often a regulatory condition, for which buyer is responsible) has not been fulfilled but only in case of breach due to fault of the buyer. If reverse break fees are agreed, the trigger would usually be where the seller simply refrains from showing up at the closing meeting and/or refuses to transfer the shares despite the buyer having fulfilled all closing conditions precedent and closing actions for which it is responsible. This shows that reverse break fees often have only a theoretical role.

Break fees are usually regarded as contractual penalties. Under Austrian law, in principle, every contractual penalty is subject to the judicial right of mitigation (restraint). This right cannot be waived in advance. However, the judge only exercises the right of mitigation at the request of a party. In any case, it remains possible to stipulate that besides the break fee the claimant may still claim damages in excess of the break fee and/or seek other remedies available under applicable law.

6.7 Termination Rights in Acquisition Documentation

The circumstances in which a private equity seller or buyer can typically terminate the acquisition agreement under Austrian M&A practice depend on whether closing has occurred or not.

- For the period after closing, acquisition agreements usually exclude all rights to terminate the contract, including those otherwise available under applicable law, to the utmost extent possible, because unwinding an M&A transaction following closing is usually impracticable – if not impossible – to achieve.
- Before closing, parties are usually given a right to terminate the agreement if clos-

ing does not happen by a certain date (the so-called "long-stop date"), or if the parties reasonably establish that closing will not occur in time, usually because one or more of the conditions precedent (such as regulatory approvals or third party consents) cannot be obtained prior to the long-stop date and such condition precedent is not waived (if and to the extent it can be waived). It should be noted that termination rights usually apply regardless of a breach by a party, but that a party shall not be entitled to terminate the agreement if it has prevented the fulfilment of a condition precedent or closing.

6.8 Allocation of Risk

A private equity seller will seek a clean exit – ie, to limit legal recourse by the buyer as much as possible to ensure the transaction proceeds can be used as return for the investors. As mentioned in **6.2 Locked-Box Considerations Structures**, parties in private equity transactions will often agree on locked-box structures. For the risk allocation this means, as a base case, that a buyer takes the target with economic effect as per the locked-box date (often in the past), while the period between the locked-box date and closing is protected by anti-leakage provisions and – starting with signing – ordinary course of business (including arms'-length) covenants.

Private equity sellers often establish a well-organised sales process that incorporates a well-structured due diligence process including virtual data rooms. With this, private equity sellers may be prepared to grant a limited set of R&W to a buyer in addition to the anti-leakage and covenant protection outlined above, but at the same time expect that all matters disclosed in the due diligence (or otherwise) operate as carve-outs to exclude warranty protection of a buyer, and ideally that everything disclosed should have been factored into pricing. This reinforces the importance of a thorough due diligence examination of the target. However, as timeframes for due diligence often tend to get squeezed, advisers may increasingly see themselves challenged to make larger due diligence teams available at shorter notice than would have been the case five or ten years ago.

If private equity sellers hold a minority stake in the target, they will be reluctant to grant business representations. If they hold the majority stake, business representations are sometimes offered, but are kept at a quite superficial level. They are often tailored to a set of R&W which can normally be underwritten by most W&I insurers – ie, private equity sellers would then offer such catalogue only in combination with a W&I insurance model. In addition, a couple of R&W will be offered only subject to best knowledge qualifiers.

A private equity seller would be prepared to allocate risk in the share purchase agreement only on the basis of a variety of limitations to the remedies available in case of a breach – ie, it would define the reimbursable damages narrowly (so as to exclude lost profits and consequential damages), insist on mitigation duties of the buyer and apply de minimis thresholds/floors and baskets as well as caps and rather narrow statutes of limitations. Any advantages associated with the (warranty) breach would have to be offset against the claim as well.

In contrast, a private equity buyer will request certain R&W coverage so that it can demonstrate to the fund investors and investment committee that standards of care and prudence were applied, so that an adequate value of the business can be expected for the money paid. A private equity buyer will also look for specific

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indemnities where the due diligence review has revealed that certain material risks have already materialised and these risks cannot be readily factored into the price. Private equity sellers regularly recognise that mutual tax indemnities are basically market standards and operate both ways – ie, the seller should be responsible for all taxes based on circumstances arising up to the locked-box date (ie, at closing), and the buyer should be responsible for all taxes based on circumstances arising after the locked-box date (ie, after closing). Other indemnities are usually heavily negotiated or rejected: while indemnities against certain identified litigation and antitrust violations have some chance of being accepted, indemnities for environmental damages are usually a red line for private equity sellers.

6.9 Warranty Protection

See **6.8 Allocation of Risk**.

While a certain minimum set of "corporate" covenants are usually accepted, private equity sellers will be reluctant to grant business representations, particularly if they hold a minority stake in the target. Statutory warranties will typically be excluded entirely. This occurs in cases of drag-along or tag-along sales of co-investment or management participations, in which case representations other than for authority and unencumbered title cannot be expected. If private equity sellers hold the majority stake, business representations are sometimes offered, which are often kept at a quite superficial level. Indeed, they may be tailored to a set of R&W which can normally be underwritten by most W&I insurers – ie, private equity sellers would then offer such catalogue only in combination with a W&I insurance model (for the purpose of achieving a clean exit).

A couple of the R&W will be offered only subject to best knowledge qualifiers, and investors will be invited to conduct a more or less thorough due diligence.

Disclosure of the data room against the warranties is usually allowed. In this respect, note that Austrian statutory law has a rule that liability is excluded for risks that "fall into one's eyes" (ie, are obvious/apparent) and for encumbrances disclosed in public registers, which is the benchmark employed absent contractual stipulation. It is not congruent with the concept of "fair disclosure" developed in the Anglo-American system. Therefore, one important negotiation aspect is to carefully define what standard of disclosure should be applied in order to constitute sufficient disclosure for eliminating a seller's liability.

Apart from offering only limited R&W, subject to certain carve-outs a private equity seller would be prepared to enter into the share purchase agreement only on the basis of additional limitations to the remedies available in case of a warranty breach. Amongst others, they would define the reimbursable damages narrowly; lost profits and consequential damages are often excluded. Sellers would insist on mitigation duties of the buyer.

Thresholds/floors and baskets are agreed in order to avoid disputes over de minimis matters. Market standards for caps vary between 10% offered by the sell side and (depending on negotiation strength) 30%, 40%, 50% or beyond that may initially be requested by the buy side. It is often an acceptable solution to go with a lower "general" cap combined with higher special caps (up to 100% of the purchase price) in case of a breach of fundamental R&W, (tax) indemnities or separate baskets.

6.10 Other Protections in Acquisition Documentation

Mutual tax indemnities are often agreeable for both parties, while additional indemnities are usually heavily negotiated. While indemnities against certain identified litigation and antitrust violations have some chance of being accepted, indemnities for environmental damages are almost always a red line for private equity sellers.

Covenants (undertakings) are also an important instrument in the share purchase agreement, and can protect both sides. As an example of pre-closing covenants, the seller undertakes to continue conducting the business of the target in the ordinary course of business and to refrain from certain unusual or extraordinary actions. As an example of post-closing covenants, the seller may agree to a non-solicitation and non-compete undertaking.

Note that indemnities and covenants are typically not subject to the same limitations regarding amounts and time as R&W.

W&I insurance has recently become a popular instrument to cover damages resulting from a breach of warranties and/or indemnities, and has found its way into M&A transactions, including in the Austrian private equity market. W&I insurers often require a certain level of due diligence so that R&W are typically excluded from the insurance cover in areas of a weak due diligence. W&I insurance is a suitable tool to cover the gap between the seller's interests and the buyer's interests. Reservations to W&I insurance models do exist (often by buyers), given that they make processes more complex and sometimes cumbersome (particularly with the parties' short transaction deadlines), and given that coverage offered by W&I insurance in some areas remains below the expectations of buyers.

Given that private equity funds may hold no other assets after the closing from which to satisfy claims for breach of R&W, indemnities or covenants, buyers often ask for safeguards in the form of an escrow or retention to back the obligations of a private equity seller. While retentions are rarely accepted, escrow structures are increasing in use but often cover only part of the limitation period that is available for remedies.

6.11 Commonly Litigated Provisions

Careful drafting of the transaction documents will keep disputes to a minimum. It is standard practice in international private equity transactions to agree on arbitration clauses, which has the following main advantages:

- arbitral awards are enforceable in a lot more jurisdictions than court judgments;
- the tribunal has experience in international private equity transactions, the types and complexities of the contractual clauses usually employed and the underlying economic aspects of such deals; and
- disputes can be kept private rather than becoming public.

If the parties cannot find an amicable solution, disputes over the closing accounts (accounting principles, calculation methods) and the related determination of the final purchase price are often left to a neutral auditor, who decides as an expert (*Schiedsgutachter*) and not as an arbitrator. Perceived breaches of R&W or indemnities are referred to arbitration if they cannot be cured in natura and no amicable settlement amount can be negotiated. It should be noted that arbitration (also depending on the institution) is associated with a certain cost factor, which can operate as a hurdle to smaller claims, so that arbitration is sometimes only instigated if and

when claims have accumulated to an aggregate volume, making arbitration worthwhile.

7. Takeovers

7.1 Public-to-Private

Public-to-private takeovers are rather uncommon in Austria, with only three takeover offers in 2021, of which only one was a mandatory offer. No public-to-private takeovers have yet taken place in 2022.

7.2 Material Shareholding Thresholds

If a shareholder of a public company (directly or indirectly) reaches, exceeds or falls below 4%, 5%, 10%, 15%, 20%, 25%, 30%, 35%, 40%, 45%, 50%, 75% or 90% of the voting rights, they are required to immediately (within two trading days) disclose such event to the FMA, the Stock Exchange and the issuer.

A public company may also provide for a threshold of 3% in its articles of association, which triggers the obligation to disclose if reached, exceeded or fallen below. The establishment of a 3% threshold may be useful for public companies with a high proportion of free float. However, the 3% threshold only gives rise to an effective obligation if the provision has been published on the company's website and notified to the FMA.

The notification obligation arises as a result of a transaction subject to disclosure.

Infringements of the obligation to disclose may result in administrative penalties, judicial sanctions, the revocation of admission to claims for compensation and the suspension of voting rights.

7.3 Mandatory Offer Thresholds

The Austrian Takeover Act (ÜbG) provides for a distinction between mandatory offers, voluntary offers and voluntary offers aimed at obtaining control.

Generally, the obligation to launch a mandatory offer for all shares is triggered if a bidder seeks to acquire a controlling shareholding, which is defined by statute as a direct or indirect controlling interest of more than 30% of the voting stock. A shareholding that gives the holder between 26% and 30% of the voting rights must, however, be notified to the Austrian Takeover Commission. An exception to this rule applies in certain cases in which an obligation to launch an offer would exist in principle due to the acquisition of a controlling interest.

In the following cases, the Austrian Takeover Commission needs to be notified, regardless of a change of control or the acquisition of control:

- a passive acquisition of a controlling interest (ie, where a controlling interest is obtained without any action having been taken by the acquirer, provided that the acquirer could not reasonably have expected to obtain control at the time at which ownership of the respective shares was acquired);
- an acquisition of a controlling interest that does not enable the acquitting party to exert a decisive influence over the target; or
- other defined exceptional situations.

7.4 Consideration

Cash is the most common form of consideration, whereas offering shares (or combinations) is rather rare. Such offers must be directed at the acquisition by cash purchase of a certain fixed amount of money. The bidder may also offer an exchange for other equity securities,

such as shares. The consideration offered in cash may not be less than the highest consideration in cash paid or agreed by the offeror for such shares within the 12 months prior to the announcement of the offer. The price must be at least equal to the average stock market price weighted by the respective trading volume of the shares concerned in the six months prior to the day on which the intention to make an offer was announced.

7.5 Conditions in Takeovers

In general, mandatory offers may not be conditional on the occurrence of certain circumstances, nor may the bidder reserve the right to withdraw from the offer. A mandatory offer may solely be subject to obtaining regulatory clearance (eg, merger control).

Purely voluntary offers (not aimed at obtaining control) and voluntary offers aimed at obtaining control may be made conditionally, if the conditions are objectively justified and their occurrence is not at the exclusive discretion of the bidder – ie, a higher acceptance rate than the statutory minimum may be provided for in the offer.

Common conditions and thus security measures available to a bidder include regulatory approvals, reaching a minimum acceptance threshold, no significant adverse changes, no compliance infringements and no changes in connection with the capital of the target – eg, capital increase, loss of half of the share capital.

Offers cannot be made conditional on the bidder obtaining financing. In the case of cash considerations, it must be ensured prior to the announcement of the intention to make the offer that the bidder can provide the cash consideration in full, but they do not yet have to effectively dispose of it.

The Takeover Commission may declare an offer unlawful if conditions are unjustified, discretionary or not objectively determinable. As a result, the Commission may prohibit its launch. Therefore, it is advisable to consult the competent authority prior to submitting an offer that includes conditions that are unusual or insufficiently precise, or where their justification is not clearly evident.

7.6 Acquiring Less Than 100%

A bidder not obtaining 100% ownership of a target may seek additional governance rights through mandatory law. The bidder may seek rights to nominate board or supervisory board members, or to have a blocking vote (more than 25%) at the shareholders' meeting.

Section 7 of the Austrian Minority Shareholders Squeeze-Out Act (GesAusG) provides a special regime for squeeze-outs effected within three months of the completion of a successful mandatory or voluntary takeover offer aimed at obtaining control. The GesAusG allows a majority shareholder holding (directly or indirectly) at least 90% of the shares to squeeze out the remaining minority shareholders. The consent of minority shareholders is not required, meaning the respective shareholders may not block the procedure. However, they are entitled to adequate cash compensation. Cash compensation below the value of the highest consideration of the takeover offer shall be deemed inappropriate. Moreover, the articles of association may state an exclusion of the squeeze-out right (opting out) or introduce a higher threshold.

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7.7 Irrevocable Commitments

The shareholder structure is typically composed of one or a few core shareholders holding large blocks of shares, while the percentage of free float shares is sometimes rather small. Therefore, it is common to approach a core shareholder first and to privately negotiate and seek an irrevocable commitment from the shareholder to sell these shares before launching a public offer. There are good arguments supporting the validity of such commitments even within the context of a public tender process, and it might be argued that such an irrevocable commitment, if made prior to the launch of a public tender offer, should remain binding in the case of a competing offer.

In the case of an irrevocable commitment by any shareholder vis-à-vis the bidder, the commitment must be disclosed.

Contractual provisions providing a way out for the principal shareholder before a tender process are rather unusual, although such a clause would appear to be legally permissible. Within a tender process, the Takeover Act gives shareholders who have already accepted a public tender offer the mandatory right to withdraw their acceptance. A contractual right of exit may be agreed for commitments that would otherwise remain binding in a subsequent tender process.

7.8 Hostile Takeover Offers

Under the Austrian Takeover Act, both friendly and hostile takeovers are permitted, but friendly takeovers prevail in practice. Either way, one of the general principles of the Takeover Act requires the management board and the supervisory board of the target company to remain neutral in the interests of the shareholders and to not in any way prevent the shareholders from taking a decision on the proposed takeover or seek to influence the decision of the shareholders.

Private equity-backed buyers do not typically engage in hostile takeover offers in Austria.

8. Management Incentives

8.1 Equity Incentivisation and Ownership

Equity incentivisation for the management team is a common feature of private equity transactions in Austria. This way, the financial investor, as the future shareholder, hopes to influence the management in their own favour and to enhance the efforts of the management after a change of the ownership of the target company. In practice, the level of equity ownership can reach up to 20%, but is generally lower, around 10%. Through the direct ownership of the management team in the portfolio company, management interests are automatically aligned with those of the private equity investor, which leads to high incentivisation.

8.2 Management Participation

Management participation is of great importance in private equity transactions and is the absolute rule in practice. Management participation is understood to mean the direct or indirect participation of the management in the target company under corporate law.

Due to the different tax consequences for the managers, the structuring needs to be carefully considered. Private equity transactions usually involve management acquiring an equity stake of the target company, often referred to as “sweet equity”. Management may receive this equity as consideration for its efforts and/or as an incentive for its future activity.

Ordinary and preferred equity are both common for management participation schemes. In case of preferred instruments, managers often receive phantom shares, which do not include voting rights but just rights to receive a share of the profit and the exit proceeds.

8.3 Vesting/Leaver Provisions

A management shareholder is usually subject to leaver provisions, which apply if they cease to be a manager of the portfolio company. Furthermore, management shareholders are typically subject to drag rights in favour of the private equity investor on the one hand, but protected by tag rights on the other. As general rule, a manager is not allowed to sell their shareholding freely – at best only to family members.

Private equity investors usually aim to ensure that the management shareholder is a manager of the portfolio company until the private equity investor's own exit. If the manager leaves the portfolio company before this occurs, private equity investors are typically entitled to acquire the management shareholder's share, whereby they seek to ensure that the leaving manager receives as little compensation as possible for such share transfer.

For this purpose, usually at least two different categories of manager's reasons for leaving the portfolio company are agreed (good leaver/bad leaver; sometimes also with intermediate categories – so-called "grey leaver"). The characteristic element of a good leaver is that the manager leaves through no fault of their own (eg, death, occupational disability or age limit). Bad leavers, however, leave on their own initiative (eg, early resignation) or are dismissed due to their own misconduct. Whereas good leavers typically have to transfer their shares to the private equity investor at full market value, the compensation for the forced return of a bad leaver's shares is regularly subject to considerable reductions.

8.4 Restrictions on Manager Shareholders

Non-competition, non-solicitation and non-disparagement clauses are very typical restrictions on management shareholders. Prohibitions of competition may arise from an employment relationship but also from a manager's corporate duty of loyalty. If a manager shareholder is also an employee of the target company, there is a legal obligation for non-competition, non-solicitation and non-disparagement deriving from this employment relation during the manager shareholder's term of employment. These obligations apply for the entire duration of the employment contract and can also be extended for a period of up to one year after the employment contract has ended.

Manager shareholders may also be bound by non-competition clauses under a shareholders' agreement for the period of their position as shareholder in the company, and for a period of up to one year from the date on which their share in the company was disposed.

8.5 Minority Protection for Manager Shareholders

Minority rights for shareholders are generally regulated by statutory law. As a rule, minority rights can only be increased and not reduced by way of a shareholders' agreement. In the case of phantom stock, dilution protection mechanisms are also regularly agreed to protect the management owning the target phantom shares from a dilution of their shareholding.

Manager shareholders usually do not have veto rights over certain matters of the company or of the holding structure, nor do they enjoy director

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appointment rights. They typically do not have a formal right to control the exit of the private equity fund but, because of their position in the company, they can indirectly influence and control the exit, especially if a potential buyer wants the managers not to leave the portfolio company.

Furthermore, manager shareholders may benefit from a tag right but are, in turn, usually also subject to drag rights of the private equity majority shareholder.

9. Portfolio Company Oversight

9.1 Shareholder Control

Over the past few years, it has become more and more established that private equity fund shareholders want not only to invest, but also to play a key role in all aspects of the portfolio company's future development. Private equity funds typically hold a majority or even all of the shares of the portfolio company.

Furthermore, the level of control of a private equity fund shareholder depends on the legal form of the portfolio company. A portfolio company is usually either a (private) limited liability company (GmbH) or a stock corporation (AG), with the GmbH being most common. If the portfolio company is structured as a limited liability company, the majority shareholder has significant control, information and instruction rights, especially in the case of a shareholding of more than 75%, as follows:

- as a majority shareholder a private equity fund may appoint or recall a managing director of the portfolio company at any time without cause and without notice;
- as shareholder the private equity fund has comprehensive information rights with regard to all aspects of the portfolio company's business, which can be exercised at any time and do not need to be justified;
- a majority shareholder can issue binding instructions to the managing directors, which have to be complied with by the managing directors; and
- a majority shareholder usually can determine that the execution of important transactions and business measures is subject to the approval of the shareholders.

Consequently, in the typical case of a portfolio company in the form of a private limited liability company, the private equity fund shareholder has significant rights that allow them to exercise substantial influence over the portfolio company.

If the portfolio company is a stock corporation (AG), the level of control of the private equity fund shareholder is reduced, because the management board of a stock corporation is not subject to shareholders' instructions. The shareholders of a stock corporation can only indirectly exercise influence on the management board via their power to appoint the members of the supervisory board of the stock corporation, but this board is not allowed to interfere in the portfolio company's day-to-day business.

9.2 Shareholder Liability

In principle, the majority shareholder of a portfolio company is not liable for the actions of this company. There are, however, exceptions to this principle, according to which the majority shareholder may be held liable under certain circumstances, so that the corporate veil would be pierced. Under the following (rather extreme) circumstances, a shareholder may be held liable for actions of its portfolio company:

- if a shareholder caused a mixing of its assets with the portfolio company's assets so that the portfolio company's assets can no longer be distinguished and separated from the assets of the shareholder;
- if a shareholder deliberately caused the portfolio company's insolvency by interventions threatening the company's existence or by a gross undercapitalisation;
- if a shareholder intentionally abuses the legal form of a limited liability company in order to harm creditors; and
- if a shareholder acts as de facto manager of the portfolio company, which means that the shareholder effectively takes over the function of the portfolio company's managing director.

9.3 Shareholder Compliance Policy

In recent years in particular, compliance policies have gained enormous importance in Austria. They play an important role at every stage of a private equity investment in a portfolio company, especially the acquisition, holding and sale of a portfolio company.

Therefore, private equity fund shareholders usually ensure that their portfolio companies comply with the fund's compliance guidelines. It is legally possible to impose compliance policies on Austrian portfolio companies, to the extent the policies are compatible with Austrian mandatory law. As this is often an internal prerequisite for a private equity fund to invest in a portfolio company, the imposition of the private equity fund shareholder's compliance policies on the portfolio companies is a common process.

10. Exits

10.1 Types of Exit

The typical holding period for private equity transactions prior to sale or disposal has increased in recent years, and currently averages around four to five years.

So far, sales to other investors (eg, to institutional, financial or strategic investors) have been observed as the most common form of private equity exit in 2022.

No dual-track sales process has yet taken place in Austria in 2022. In the past, however, dual-track sales processes have been observed. Nevertheless, selling to other investors has always been the most common exit type in Austria.

Private equity sellers sometimes do reinvest upon exit, but this is not typical for an average private equity exit in Austria.

10.2 Drag Rights

Drag rights are a typical part of private equity arrangements in Austria. There is a high need to include contractual drag rights into private equity arrangements, and such rights are also regularly utilised by private equity sellers.

In general, a drag right of the majority private equity seller only applies if at least 50% of the total share capital of the portfolio company is sold (usually even a sale of 75% of the total share capital is required). Furthermore, a drag right of a private equity seller often only applies after the expiry of a minimum holding period of two to three years and/or if a minimum share price is achieved.

Institutional co-investors are regularly excepted from a private equity seller's drag rights, unless

the institutional co-investor holds just a small shareholding in the portfolio company (not more than 5–10%).

10.3 Tag Rights

When a private equity shareholder sells a stake, management shareholders regularly enjoy tag rights, which means that the management shareholders are usually entitled to sell their shares along with and under the same conditions as the private equity seller.

Typically, the management shareholders are entitled to co-sell all or parts of their shares in the portfolio company if the majority private equity fund shareholder sells at least 50% of their shares in the portfolio company. Such a tag right usually also applies to institutional co-investors, provided that such institutional co-investor only holds a comparatively small shareholding in the portfolio company (not more than 10–15%).

10.4 IPO

In the context of an IPO, lock-up periods are regularly agreed for the private equity seller, which means that the private equity seller may not sell a portion of its shares for a certain period. This lock-up period is usually up to six months, but can also be longer.

Relationship agreements between the private equity seller and the target company have been seen in the past in the context of IPOs. To the extent such agreements do not just contain undertakings of the private equity fund shareholder towards the target company but also obligations of the target company towards its shareholder(s), the strict Austrian capital maintenance rules have to be complied with. According to these capital maintenance rules, any obligation of a stock corporation established in favour of a shareholder generally has to be on arm's-length terms.

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CERHA HEMPEL Rechtsanwälte GmbH has 26 partners and 76 senior attorneys and associates in Austria; the firm also has offices in Bulgaria, the Czech Republic, Hungary, Romania and the Slovak Republic. The corporate team is active for clients in the private M&A markets of Austria and CEE, representing strategic and private equity investors as well as their targets and/or management. It also advises on national and international cross-border mergers and reorganisations, specialising in developing and providing practical solutions to what can be extremely complex issues that often involve cross-border components. Due to the diversity of its clients, the team is particularly experienced in advising on public M&A, including takeover law and related disclosure requirements under stock exchange law.

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