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The International Comparative Legal Guide to:

Private Equity 2018

4th Edition

A practical cross-border insight into private equity

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EDITORIAL

Welcome to the fourth edition of *The International Comparative Legal Guide to: Private Equity*.

This guide provides the international practitioner and in-house counsel with a comprehensive worldwide legal analysis of the laws and regulations of private equity.

It is divided into two main sections:

Four general chapters. These chapters are designed to provide readers with an overview of key private equity issues, particularly from the perspective of a multi-jurisdictional transaction.

Country question and answer chapters. These provide a broad overview of common issues in private equity laws and regulations in 34 jurisdictions.

All chapters are written by leading private equity lawyers and industry specialists and we are extremely grateful for their excellent contributions.

Special thanks are reserved for the contributing editors Richard Youle and Lorenzo Corte of Skadden, Arps, Slate, Meagher & Flom LLP for their invaluable assistance.

Global Legal Group hopes that you find this guide practical and interesting.

The *International Comparative Legal Guide* series is also available online at www.iclg.com.

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1 Overview

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

As Germany is a well-developed and sophisticated private equity market, one sees all kinds of transaction types that are typically found in other mature markets. While the straight-forward sale or acquisition of all, or a majority of, the share capital or assets of a company is the predominant transaction type, minority investments in (publicly listed) companies, private equity-backed takeovers of publicly listed companies, joint ventures, distressed acquisitions as well as debt-to-equity swaps, often in some part debt-financed, can also be regularly seen in the market place.

The general market conditions have improved over the last few years and in particular, within the last year and the time of this year, we saw a strong rise in the number of transactions and deal volumes in the German market. The market rise is primarily due to big buy-out deals as well as buy-outs in the German mid-cap market. Currently, there is a clear dominance of classical (often debt-financed) buy-out deals, particularly in the tech and medical space. Also, minority transactions in German mid-cap companies can currently be seen quite often. In general, we see an increasing number of Warranty & Indemnity insurances ("W&I insurance") having been concluded in connection with private equity transactions (and the potential risks associated with the guarantees given in the underlying agreements).

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

Germany has a large pool of mature, medium-sized companies that are often (worldwide) market leaders in their area (the "German Mittelstand"), plus a vivid start-up scene, i.e., the number of potential targets for private equity is larger than in any other European market. Combine this with a reliable and educated legal system, the availability of debt for leverage buy-outs and a capital market that may build the bridge for an exit scenario and you have what makes Germany an attractive market place. The general perception towards private equity, especially among the owners of medium-sized companies, is what held the market back in comparison to, e.g., the UK market. But this has also improved over the last years and nowadays even the shareholders of medium-sized (family) companies have set aside their reservations.

2 Structuring Matters

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

The acquisition structure is influenced by tax considerations of the investor(s), financing requirements, the potential exit scenario, liability considerations and other aspects. Most typically, one sees a non-German TopCo (often Luxembourg-based), which holds a German AcquiCo, which, in turn, then acquires the German target, mostly being a German HoldCo.

These structures are well-developed and can mostly be seen in the market. Minority or joint investments are rather exceptional structures and are mostly contingent on the characteristics of the respective target.

2.2 What are the main drivers for these acquisition structures?

See the answer to question 2.1 above.

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

The structuring of the equity depends on the chosen acquisition structure. In a typical scenario with a non-German HoldCo and a German AcquiCo, the equity of the German AcquiCo consists of ordinary equity, sometimes coupled with a shareholder loan given by the non-German HoldCo or preferred shares in the German AcquiCo to mirror equivalent instruments at the non-German HoldCo level. Typically, at the non-German HoldCo you will then find ordinary shares, hybrid instruments such as preferred shares or shareholder loans, as well as preferred distribution rights in certain scenarios.

2.4 What are the main drivers for these equity structures?

The main drivers are tax and corporate governance considerations, as well as the requirements of the financing banks to achieve structural subordination.

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

One sees good leaver, bad leaver and vesting provisions most typically structured in such a way that a certain part of the equity vests over a certain period of time and with an option for the company/investor to purchase the equity of the manager in case of departure at a certain price, which depends on whether the manager is a good or bad leaver.

Good leaver scenarios are usually the termination of the service relationship by the company without cause, the expiration of a service agreement without the company offering an extension on at least equivalent terms to the manager, and illness of a manager. All other reasons would then typically (depending on the bargaining power of the parties) qualify as bad leaver events.

One has to keep in mind, however, that the economically desired result may conflict with the actual taxation of the managers, in particular given the fact that the German tax authorities had taken a more rigid stance concerning some particular features in management equity programmes ("MEPs"). The good thing is, however, that the German Federal Fiscal Court (the highest tax court in Germany) has ruled against the more rigid stance of the tax authorities and has thus provided some certainty on the beneficial tax treatment of certain features of MEPs.

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

In such a scenario, the investor is usually not able to leverage its investment and hence debt-driven structuring aspects can be neglected. If the minority investments form part of a joint investment strategy with other investors, debt-driven structuring aspects may gain importance again.

3 Governance Matters

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

The governance arrangements depend in part on the legal form of the target and of the other companies in the acquisition structure. Assuming the most typical case of a German AcquiCo and the German target both have the legal form of a limited liability company (GmbH) and less than 500 employees, one will typically find that some or all of the top target management assume the role of a managing director of the target, advised and overseen by a voluntary advisory board, with the management of the German AcquiCo then usually consisting of appointees of the investor and in some cases the CEO of the target.

The management of the target company (and any company below it) would need to follow a pre-defined set of rules of procedure, which typically require that the management seeks the prior consent of the shareholders or of the advisory board in case important measures are concerned (the list of important measures is implemented on a case-by-case basis and largely depends on the characteristics of the target (group)). These rules of procedure, and the stipulation of (voluntary) advisory boards in the structure, which have information and consent rights and the right to remove and appoint the management, are the most relevant governance rights for the investor to exercise "control" also on the operating level.

Again, tax and other considerations (e.g., ERISA) of the specific investor need to be observed, in particular as it concerns which rights are ultimately granted, who shall be sent as appointee of the fund into the relevant boards, and which operating decisions ultimately require investor (or shareholder/board) consent.

Furthermore, in cases where certain employee thresholds are surpassed, co-determination rights of employees need to be observed. In practice this is much less of an issue as it first may sound to a non-German investor and there are ways to address and mitigate these concerns.

Where and to what extent such structures need to be disclosed depends on how they have been implemented (e.g., articles of association versus by-laws) and on some target specific facts. As a rule, it is achievable that no detailed disclosure needs to occur.

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

Yes, they do, however, not by virtue of law but by the implementation of the measures as described above. Usually the list of veto rights is rather detailed, but one has to keep in mind that the investor neither wants to assume the role of a factual-manager (e.g., with regard to liability in insolvency scenarios), nor create a tax presence in Germany by virtue of its too narrowly defined consent rights.

In case of a minority position, the veto rights are weaker and usually only provide protection as it concerns key aspects such as structural measures that affect the target group as a whole, exit scenarios (details are usually very specific), capital increases, and related party transactions.

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

Besides the risks referred to above, veto arrangements are, in general terms, only relevant as it concerns the relationship between manager and investor, but do not invalidate actions which the manager may take *vis-à-vis* third parties in violation of such veto arrangements (save for certain exceptions). Hence, the hurdle for qualifying veto arrangements between the investor and managers as invalid is rather high and mostly relates to circumstances which invalidate any other contractual arrangements as well (e.g., violation of general principles of law).

This is, however, a rather theoretical discussion, as investors will usually ask for fewer veto rights than what would be legally possible in order to avoid the risk of being treated as a "factual-manager" and any potential negative tax consequences.

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

The rights and obligations of shareholders among each other are not extensive and courts have generally followed the concept that is expressed by law, i.e., that shareholders are free to agree on the rights and obligations that govern their relationship in the

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respective corporate documents. The nuances depend on the legal form in question and whether the target company has a small, more personalised investor base versus a diverse, large investor base in the case of a publicly listed company.

As a general rule of thumb, German law requires that structural measures such as mergers and capital increases require a majority of 75% of the votes. If the investor achieves these thresholds on its own, then the investor owes no further duties to the minority/management shareholders, unless stipulated in the articles differently or the minority/management shareholders would be able to show that the respective decision was taken to intentionally harm them – a rather high standard. But again, variances exist depending on the legal form in question.

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

Germany accepts that contractual agreements between two or more parties are governed by laws of jurisdictions other than Germany as long as these do not conflict with the *ordre public*, which is a pretty high threshold. The same applies to the applicable venue. However, one has to observe certain formalities in order to have a valid venue and choice of law provision. While non-compete and non-solicit provisions are generally permissible and enforceable, one has to be very careful in their drafting, as an over-excessive provision can make the entire provision invalid.

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

Besides the tax considerations referred to above, there are limitations on the maximum number of board positions someone can hold in a German stock corporation. Furthermore, German stock corporations have a two-tier board system and one and the same person cannot be part of the management board as well as of the supervisory board (the latter is supposed to oversee and control the management board). The same principle applies to voluntarily established boards that exercise a control function over management.

More importantly, assuming a position as a manager or supervisory/advisory board member entails the risks of violating the fiduciary duties that come along with such a position, and while Germany has also enacted a business judgment rule, a concept protecting managers and board members while exercising their duties, German courts tend to review board actions more and more critically and demand that companies, in fact, pursue former or current board members and managers for alleged misbehaviour.

If an instance of misbehaviour (which can vary from an uninformed business decision to personal entrenchment) is found, the respective manager and board member is then personally liable for all damages caused by it. However, the (often difficult) burden of proof lies with the company.

In order to mitigate these potential risks, D&O insurances are usually sought for managers, board members and (other) nominees. Further, private equity investors try to avoid that nominees assume manager positions, but rather take on advisory board functions.

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

Although it may sound surprising, reality shows that this is rather a theoretical problem and is, in practice, much less of an issue than expected. Firstly, because nominees of private equity investors would usually not assume a manager position (where one has the issue of a statutory non-compete obligation for managers) for the reasons described above, but rather become a member of a supervisory or advisory board, where they are usually not under a non-compete obligation and exercise only negative control and are hence much less exposed to liability risks. Secondly, all that German law usually (variances depend again on the legal form in question and what the corporate documents say about it) demands from a member of an advisory board or supervisory board is that he acts in the best interest of the company on whose board he is serving, and hence the interests are usually aligned with that of the private equity investor. Lastly, the burden of proof of a violation of the duties of the board member lies with the company and such burden of proof is usually hard to meet in practice.

4 Transaction Terms: General

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

Regulatory approvals may be required if the transaction and the involved parties are of a certain size so that antitrust clearance is required, or the target operates in certain industries of particular importance to Germany, such as media or defence (in which case special clearance in addition to antitrust clearance is required). Except for extraordinary cases, the regulatory approval process usually only takes around one month and can be conducted between signing and closing.

More time-consuming are certain aspects which diligent buyers find in other jurisdictions as well, i.e., the due diligence process, negotiation of appropriate transaction documents and, if needed, the arrangement of financing. Germany is, however, a sophisticated market with experienced players and hence these topics can usually be dealt with in a time frame of two to four months (and one also still sees transactions that are completed within two weeks only, although this is rather exceptional).

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

Within the last year and the time of this year, the private equity market in Germany has risen strongly overall. This development is mainly driven by an increase of targets in the market and the availability of bank financings at very favourable conditions. Further, we saw many buy-out transactions in the German mid-cap market segment (the “German Mittelstand”) – this market segment is increasingly focused on by private equity investors. In addition, many funds are currently very rich on cash and are facing a substantial pressure to invest. Beyond that, an increasing trend is that W&I insurance has been seen in many transactions. A W&I

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insurance takes over (certain) risks associated with the warranties and indemnities regularly given by the sellers as part of the purchase agreements.

5 Transaction Terms: Public Acquisitions

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

Public-to-private transactions require a different tool-set than privately negotiated transactions and investors need to be aware of that. We have advised on one of the very few public-to-privates that occurred in the German market in the last few years and observed first-hand how surprising the legal set-up for this kind of transaction in Germany is for investors, particular for Anglo-American investors.

The challenges can be broadly classified into the following categories: (1) availability of information for due diligence; (2) seeking support by the management of the target and certain shareholders; (3) the acquisition process of shares including the tender offer; (4) ensuring the financing, in particular in light of the strict financial assistance system that applies to a German stock corporation; (5) ensuring the exercise of control and access to the cash flow of the target via domination and profit and loss pooling agreements; and (6) conducting a squeeze-out of minority shareholders to the extent the requirements are met.

As each of these steps require an in-depth analysis of the applicable legal regime in Germany, broad and general statements do cause harm here and interested investors are better advised to seek early legal guidance (before the first share in the target is acquired) if they intend to do a public-to-private transaction. Finally, there is just one more general remark: despite the peculiar legal setting in Germany, public-to-privates are possible if investors are willing to educate themselves and are patient.

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

The concept of break-up fees is available in Germany, but attention has to be paid to how it is structured, the amount of the break-up fee in relation to the transaction size and the cost actually incurred by the respective bidder. Furthermore, the triggering events of when the break-up fee becomes payable have to be defined carefully.

One can find break-up fees regularly in cases of a public takeover, usually drafted as a cost reimbursement clause. The amount of the fee depends on the actual frustrated costs the bidder asks to be compensated for (this can be explained by the legal justification for such clauses in Germany) and hence usually do not exceed 1–3% of the transaction value (depending on the transaction value). In a private transaction, one does not usually find such clauses, as the seller is generally obliged to deliver the sold shares/assets on closing and if he does not stick to this obligation, the buyer is entitled to demand damages.

6 Transaction Terms: Private Acquisitions

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

In the case of an acquisition of a privately-held company, it is typically either a locked-box-based or a closing accounts-based purchase price, sometimes coupled with earn-out provisions and vendor loans. Also, reinvestments by sellers are seen regularly. In case of a publicly listed target, the consideration is usually a straight-forward cash purchase price; a consideration in the form of an exchange offer is rather exceptional.

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

The general rule is that private equity sellers offer almost no warranties/indemnities, as they otherwise cannot show a clear exit to their investors. This general rule has, however, been more and more contested and nowadays one sees structures where either a warranty insurance bridges the gap between the offered and sought protection of buyers, or private equity sellers accept to grant a greater warranty/ indemnity package to the buyer if recourse for potential claims can only be sought by raising claims to an escrow account that is funded by a relatively small portion of the purchase price.

As management is concerned, one sees that they either participate in the same warranty/indemnity package granted by the selling private equity investor, or give warranties and indemnity to a greater extent, in particular in cases where they re-invest their funds into a new structure set up by the buyer.

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

The standard package consists of no leakage covenants and guaranties (in very general terms, guaranties are the German equivalent to warranties), a title and authority guarantee and a standard financial statement guarantee. In case it is absolutely required to make a deal happen and the liability of the seller is capped at a small portion of the purchase price and with recourse for potential claims being limited to an escrow or similar account, then one also sees a more standard approach, with detailed ordinary business conduct covenants, standard guarantees for matters such as employment, litigation, compliance with law, real estate and finance and a tax indemnity for past tax periods.

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

Yes, one sees W&I insurances more and more in the German market and in particular in the last year and the time of this year, we have seen a warranty and indemnity insurance in almost every

Germany

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transaction. Excluded from the "typical" W&I insurance package are known risks or statements where the due diligence exercise has been weak. The competition among W&I insurance providers is currently so high that even insurance packages with no or very low deductibles are being offered.

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

The liability concept is usually narrowed both in terms of time and money. The parties usually foresee that standard breach of covenant or guaranty or indemnity claims can only be raised for a relatively short period of time after closing, whereas claims for title or no leakage have a longer statute of limitation. It is then also provided that the liability of the seller for these standard claims is capped at a relatively low percentage of the purchase price (often with *de minimis* and threshold/basket concepts reducing the exposure of the seller further), with recourse often only being available to a certain escrow or similar account funded out of the purchase price (and the terms of which usually match the statute of limitations and liability thresholds). More fundamental claims, such as claims for a breach of the title or no leakage guarantee or covenant, are then usually capped at the purchase price.

By operation of law, the entire liability concept becomes null and void in case of an intentional misconduct by the seller, and this is often repeated (while not necessary) in the transaction documents as well.

One can see in the market that warranties are only given by the (re-investing) management team, subject to clearly defined liability limitation or W&I solutions, whereas the private equity seller then only assumes warranties as to title, no authority and no leakage.

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

Yes, escrow accounts are usually provided for, in particular, if no warranty insurance is concluded.

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

It depends on what is demanded by the seller, but the most common instrument is the so-called equity commitment letter issued by the fund itself or a similar entity. The details of such letters then vary on a case-by-case basis, depending on what the seller demands and what the standard practice of the fund is. Usually, sellers are granted a right to claim funding from the fund into the acquisition structure.

Where the availability of debt financing is concerned, the buyer typically has to show to the seller some form of debt commitment letters, which may provide for a hard debt commitment by the financing banks.

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

No, these clauses are rather uncommon in the German market, as transaction security is a very high parameter for sellers in the German market and such reverse break fees, coupled with the walk-away right of the buyer, result in weakened transaction security for the seller.

7 Transaction Terms: IPOs

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

IPOs usually do not allow for a full, immediate exit by the private equity seller, as lock-up commitments may need to be given by existing shareholders. Even after lapse of these commitments, a sale of a substantial amount of (remaining) shares may negatively impact the share price and may raise questions about the prospects of the company (unless, e.g., such strategy is communicated via the prospectus).

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

It depends on the respective case at hand, but lock-ups for a period of six to nine months are not uncommon.

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

Dual-track proceedings can be seen in Germany, particularly for large-cap transactions and when the IPO environment is favourable. Companies are frequently exited, however, via a sale and the IPO road is abolished rather late in the process in order to continue to put pressure on the buyers in terms of pricing.

8 Financing

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

Debt financing is predominantly provided by financial institutions in the form of acquisition finance, sometimes combined with mezzanine financing provided by special mezzanine capital providers. In larger transactions, one also sees bond financing and debt fund financing, but usually then governed by English law. The appetite for acquisition-related financing is currently healthy in the German market. However, due to the easy availability of debt financing by financial institutions the need for mezzanine capital is currently very limited, and the market for bond financings has dried up to a large extent.

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

In order to provide for a debt-push down, one typically needs to seek a profit and a loss pooling and domination agreement between the borrower and the OpCos (or a chain of such agreements in the structure). While this is a rather standard agreement and easy to get in case of an acquisition of all shares outstanding of the target, it may become really challenging if outside shareholders with a stake of more than 25% are involved. Without such an agreement, the granting of upstream loans and guarantees may become a real challenge.

As already addressed in question 5.1 above, the legal restrictions on financial assistance by a German stock corporation have a significant impact on the structure of debt financing.

9 Tax Matters

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

Germany has enacted, like many European countries, interest barrier rules which limit the amount of interest that can be offset in the profit and loss statement for tax purposes. Another key topic is to structure the transaction in such a way that the private equity fund and its personnel do not become tax resident in Germany, simply by the way consent rights are structured or board rights are exercised.

Off-shore structures are not uncommon; however, these are implemented in the structure of a private equity fund way above a German AcquiCo or HoldCo and do hence not pose a feature of the German private equity market.

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

An important factor is to avoid having the roll-over treated as a taxable event without having, at the same time, a liquidity event for the manager that allows him to pay taxes that may result from it.

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

The most tax-efficient arrangement is still investment via a special partnership, formed for the purpose of bundling the investment of all managers and then investing into the equity of the acquisition vehicle. In such partnership, one would find the relevant leaver and vesting terms agreed. The tax treatment of investments made by managers (indirectly) in their own company was subject to significant changes in the past few years. The tax authorities had pursued a strict approach and tended to qualify the gains resulting from such investments as taxable employment income. However, the German Federal Fiscal Court ruled that such gains are, if certain conditions are met, to be treated as capital gains. In the case referred to in the foregoing, the German Federal Fiscal Court qualified the gains not only as capital gains but even as non-taxable capital gains. Due to these recent changes, management participation structures regained more certainty from a tax law perspective.

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

The tax treatment of management participation structures underwent significant changes in the recent past. As described in question 9.3 above, the German Federal Fiscal Court ruled that gains resulting from a management participation are, subject to certain conditions being met, to be qualified as capital gains and eventually even as non-taxable capital gains. See also above.

10 Legal and Regulatory Matters

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

In general, one can say that there are no laws that specifically address, or discriminate, private equity transactions, and this is one of the reasons why Germany offers a rather safe legal system for these kinds of transactions.

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

Certainly, the interest barrier rules had an impact on private equity transactions, in particular on the level of debt that has been used in transactions. Further, as in every other European country, the implementation of the AIFMD into German law had an impact on the fund formation side (but not so much on the deal side).

While not being a regulatory initiative yet, ESG topics are becoming more and more important for private equity funds and their portfolio companies, as institutional investors push for the implementation of respective reporting and monitoring.

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

Due diligence is, in almost every case, conducted by outside counsel and is usually rather detailed, covering all relevant legal aspects of the target including contracts, compliance with law, corporate measures, real estate, employment, etc. It is usually done in a four to six-week time frame, depending on how well prepared and committed the seller is and how many resources the buyer devotes to it. In highly urgent cases, it can also be done within a two-week time frame, but then certain areas are usually carved out or very high materiality thresholds are applied.

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

Yes, nowadays compliance is part of the usual due diligence exercise of a private equity investor.

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

While such a liability may in theory be possible, in practice this does not become an issue, as it can be avoided by the correct structuring of the transaction. The same applies for cross-liability among portfolio companies.

11 Other Useful Facts

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

Most of the relevant factors have already been addressed in the foregoing.

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