

Austria

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- 1** What are the different types of private equity transactions that occur in your jurisdiction?

In a benchmark paper, *Benchmarking European Tax and Legal Environments*, published by the European Private Equity and Venture Capital Association (EVCA) in May 2004, Austria is ranked below average for its tax and legal environment as being not favourable to the development of private equity and venture capital. The reasons being, inter alia, the fact that Austria is generally not providing specific favourable company tax rates for small and medium-sized enterprises (SMEs), the relatively high corporate income tax rate for corporations, and the limited fiscal R&D incentives for capital expenditures. However, compared with the results for 2003, Austria has improved in the EVCA ranking. Starting from 2005 Austria has lowered its corporate income tax rate to 25 per cent.

Further, to a certain extent *Mittelstandsfinanzierungsgesellschaften* (MFAGs), which are often used by Austrian private equity firms, are subject to a favourable tax regime (see 14 below). Accordingly, the Austrian venture capital market may cautiously be described as growing, in particular since Austrian private equity firms have made their first successful acquisitions. The very positive development of the Vienna Stock Exchange has also raised interest by international venture capital investors who have since proved to be active on the Austrian market. Austria therefore sees various kinds of venture capital investments, ranging from seed-financing to mature private equity investments.

The last years have also shown international venture capital investors acquiring considerable stakes in Austrian companies, eg KKR in Zumtobel AG, a lighting company, and VSS and 3i in Herold Business Data, the Austrian publisher of the *Yellow Pages*.

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

In 2002 Austria introduced the Austrian Code of Corporate Governance (the Code). The Code primarily applies to Austrian listed companies. It is based on the provisions of Austrian corporation law, securities law and capital markets law as well as on the principles set out in the OECD Principles of Corporate Governance. It is also recommended, although not mandatory, that companies not listed on Austrian or foreign stock exchanges follow the Code to the extent that the rules apply. Companies can voluntarily undertake to adhere to the principles set out in the Code.

All listed companies are called upon to make a public declaration of their commitment to the Code and to adhere to the

Code's rules, monitored by an external institution on a regular and voluntary basis, with findings reported to the public. The Code is neither a statute nor a decree. Adherence to the Code is voluntary. Primarily, no legal consequences are connected to non-adherence to the Code's provisions. However, nearly all stock corporations listed on the Vienna Stock Exchange have declared their compliance with the Code. Private companies, however, have not regularly adhered to the Code.

Therefore it is proposed to transform the most prominent regulations contained in the Code into statutory law in the Austrian Company Law Amendment Act 2005. According to this Act, in particular the rules on the supervisory board and its independence and transparency have been enhanced. In order to avoid conflicts of interest, members of the management board may accept functions in the supervisory board of other companies only after having obtained consent from the supervisory board. Further, in order to safeguard independent audits, audit firms are, inter alia, excluded from auditing a company if they have rendered services to the company in a material way or if they have audited a company more than five business years in any 10-business-year period. Moreover, any publicly traded Austrian corporation has to establish an audit committee. In the case of non-publicly traded corporations, an audit committee only needs to be established if the supervisory board consists of more than five members.

Considering the proposed amendment of the Austrian Company Law Amendment Act 2005, one proposed provision is of particular interest: the draft legislation provides a direct liability of the management of listed companies in the case of misleading financial information given by management. Since Austrian law in general does not know the concept of derivative suits, such provision is somehow revolutionary and may be viewed as being harsh considering the general concepts of remedies available to shareholders under Austrian Corporate and Stock Exchange Law. Liability, however, only arises in the case that management acts with gross negligence.

- 3** How can management of the target company participate in a going-private transaction? What are the principal executive compensation issues in going-private transactions?

Austrian law knows both participation of management of target companies in employment agreements and equity-based incentives. In employment agreements, management is often party to flexible compensation schemes, in most cases depending on earnings before interest and taxes, turnover or after-tax profit figures. As far as stock corporations (*Aktiengesellschaften*) are concerned, the Austrian Stock Corporation Act provides that a flexible compensation of management essentially has to result in a

participation in the annual profits of the respective company.

In any case, the supervisory board has to take care that the aggregate compensation of management (ordinary compensation, incentive-based compensations and other payments) has to be in an adequate proportion to the functional tasks of management in the respective company. Management may further be granted stock options, for which certain criteria as to transparency and fairness are contained in the Code. Moreover, Austrian stock corporation law knows facilitated rules on share buy-back programmes for the back-up of management stock options.

Other instruments include the issuance of *Genussrechte* and similar profit-participating instruments which may grant essentially the same rights as shareholders have but exclude management from any voting rights.

It should be noted that Austrian corporate law (Section 66a of the Austrian Stock Corporation Act) does not allow for the target company to finance or participate in any financing of the investment to be made by the respective member of the management board in order to be eligible for or fulfil its obligations under an incentive-based programme.

- 4** What are the issues facing boards of directors of public companies considering entering into a going-private and/or private equity transaction? What is the role of a special committee in such a transaction where management members of the board are participating in the transaction?

According to the Austrian Takeover Act, publicly listed companies may only be taken over pursuant to a takeover bid following detailed rules on content and pricing contained in the Austrian Takeover Act. The Austrian Takeover Act specifically sets forth the principles of equal treatment of all shareholders, equal information rights of all shareholders, transparency of takeover situations to all stakeholders, the prohibition of insider dealings, as well as the principle of diligence of the management board and the supervisory board of the target.

With regard to any takeover bid, the management board and the supervisory board are generally prohibited from any action which could impede the free and informed decision of each shareholder on the takeover bid. Hence, the management board and the supervisory board of the target company are prohibited from any action which could result in a failure of a takeover attempt except such action is approved by way of a shareholders' resolution.

Further, it needs to be considered that the management board of a target company may be subject to a conflict of interest in case all or certain members of the management board have a specific interest in a positive result of the takeover bid. In particular, in management buyout situations the management is not entitled to issue any recommendation with regard to the takeover bid, but pursuant to the principles of neutrality and transparency have to publish their conflict of interest and consequently have to refrain from any further action facilitating a positive result of the takeover in their function as members of the management board of the target. In such a situation, members of the management board and members of the supervisory board may be barred from exercising their voting rights in the corporate bodies forming a decision on the takeover bid.

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

According to the Austrian Takeover Act, a going-private transaction of a publicly listed company may only be effected pursuant to a public takeover bid. Any bidder obtaining a controlling inter-

est in a listed company has to make a mandatory bid. Such bid has to be published at the latest 20 trading days after the controlling interest has been obtained. A takeover bid may be kept open for 50 trading days at the maximum. The offer price must at least equal the higher of the average share price of the target over the last six months preceding the acquisition of the controlling interest, and any transaction price minus 15 per cent paid in a private transaction by the bidder during the last 12 months. Such 15 per cent discount only applies in case of cash transactions.

Austrian Stock Exchange Law generally does not provide for the possibility of voluntary delisting. Therefore a delisting of a company from the Vienna Stock Exchange has to be achieved through a corporate reorganisation by way of a squeeze-out of the remaining minority shareholders.

Such squeeze-out is generally only possible once the bidder has obtained at least 90 per cent of the total outstanding share capital of the target company and may be performed, in principle, either by way of a disproportionate demerger of the minority shareholders or by way of a merging transformation. In the course of the disproportionate demerger, minority shareholders will be spun off to a newly formed company (cash box) containing liquid assets corresponding to the value of the minority shareholders' interests. Such cash box may be liquidated at a later stage. The merging transformation is essentially similar to an upstream merger, where the minority shareholders receive a cash compensation instead of shares in the absorbing parent company. In both cases there are certain procedures under corporate law in order to safeguard that the minority shareholders are adequately compensated.

For both squeeze-out mechanisms described above, Austrian Corporate Law provides for enhanced disclosure requirements, in particular in order to protect the interests of the minority shareholders, the creditors and the works council.

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

Basic tax issues involving private equity transactions in Austria in general relate to the structuring of the investment itself, the distribution of dividends, as well as the servicing of acquisition indebtedness and the tax-efficient exit of the shareholders.

When entering into the investment it needs to be considered that Austria, in general, levies capital duty amounting to 1 per cent for any capital contribution made to an Austrian company. In this regard it doesn't matter whether an actual capital increase takes place or not.

From 2005, interest expenses payable on debt incurred for the acquisition of shares are deductible for tax purposes. However, one needs to consider that target companies still have to distribute dividends in order to service the debt obligation of the acquiring parent company and that dividends can in general only be distributed once during any accounting period under Austrian corporate law (one intermediary dividend may, however, be payable in case of joint stock corporations if certain requirements are met). Further interest payments will only be deductible if such payments comply with the arm's-length standard. The same holds true for any compensation paid to management regarding stock options and deferred compensation plans.

Further, other new developments entering into force on 1 January 2005 include the possibility of goodwill depreciation in case of share deals. In general, goodwill may only be capitalised

for tax purposes in the course of an asset deal. However, if the target company becomes part of an Austrian tax group (*Unternehmensgruppe*) it is now, in principle, possible to capitalise and depreciate goodwill also in case of a share deal. Such new provision has been enacted in order to provide investors with a level playing field when making the decision whether to make an investment by way of an asset deal or a share deal. However, this goal has not been quite reached because the Austrian legislator inserted certain restrictions in order to limit any goodwill depreciation in the case of a share deal. Such restrictions include, inter alia, that a goodwill depreciation may only be made if the target company is an Austrian operative corporation and qualifies as a group member after completion of the acquisition. The acquirer needs to own more than 50 per cent of the value and the voting rights of the target company for such purpose. Further, there are quite complex rules on calculating the amount of any goodwill to be capitalised for tax purposes. In general, the difference between the acquisition costs and the net equity of the target company as determined for accounting purposes (thereby adding any inherent gain on non depreciable fixed assets) is eligible for goodwill depreciation. The maximum amount of goodwill to be capitalised for such purpose corresponds to 50 per cent of the acquisition costs.

7 What are the timing considerations for a going-private transaction or other private equity transaction?

Timing of the transaction in all cases depends on the prospective transaction structure. As to the structure of the transaction, there are certain deadlines provided for by law which have to be taken into account by the venture capital investor. Past practice has shown that a takeover procedure takes roughly three to four months from the first contact with the Austrian Takeover Commission until publication of the final result of the takeover bid. For the going private of the company once taken over, the squeeze-out of the minority shareholders according to the law takes at least a further three months; although, according to precedents, it may take even longer before definitive registration of the respective squeeze-out measure by the commercial register. In any event, each corporate restructuring measure leading to the squeeze-out of the minority shareholders needs to be resolved on by at least 90 per cent of the total outstanding share capital.

8 What purchase agreement issues are specific to private equity transactions?

According to Austrian stock corporation law, the target company in any event is prohibited from providing financing or assistance in financing of the acquisition of its own shares. Such financing or assistance of financing violates Section 66a of the Austrian Stock Corporation Act, resulting in the management becoming liable for damages. Further, any such financing generally results in a violation of capital maintenance rules because of unlawful repayment of equity under Section 52 of the Austrian Stock Corporation Act (Section 82 of the Austrian Act on Limited Liability Companies), causing the transaction to be null and void.

In the course of loan-financed structures, banks and other lenders on a regular basis intend to have their debts secured with assets of the target's group. Contrary to the pledging of shares, lenders may at the due time of payment of such loans enforce their receivables by getting hold of the group assets. However, such pledging of assets of the target company generally violates capital maintenance rules resulting in the transaction being null and void. Therefore, any pledge, guarantee, surety, mortgage or any

other security right granted by target to the financing bank without target receiving adequate economic consideration and further without the management of target having undertaken a due risk assessment of such security, stands in conflict with mandatory provisions of Austrian law.

The guarantees and representations and warranties to be declared by the seller depend on the respective deal structure. At least, precedents show that unencumbered ownership of the shares to be sold has to be guaranteed. In addition, ordinary guarantees and representations and warranties relate to the ownership of target in subsidiaries, annual statements, payment of taxes and other duties, non-existence of change of control provisions, compliance with environmental law as well as any further representations and warranties pursuant to the results of a due-diligence review.

The instrument of indemnification normally is adapted to the legal instruments provided by Austrian law. Acquisition agreements usually contain provisions on indemnifications either being dependent on seller's fault and/or purchaser being under an obligation to prove the diminution in value of the respective business of the target company. However, Austrian law does not prohibit a system of indemnification being independent from any recourse to fault or proof, resulting in the seller being fully liable for the business transferred to the private equity investor, in a manner similar to a guarantee.

9 What issues are raised by existing indebtedness at a potential target of a private equity transaction? How are these issues resolved in connection with a private equity transaction?

In case of existing indebtedness of target, one needs to consider certain restrictions for leveraging up companies under Austrian law. Such restrictions are of particular importance since most of the private equity transactions in Austria are heavily debt financed.

Generally, under the Austrian Enterprises Reorganisation Act (the URG) an Austrian company has to initiate a quite complex reorganisation procedure in case the target company has less than 8 per cent equity or a deemed debt redemption period of more than 15 years. Further, in such case certain liability issues may arise for the management. Moreover, in case an Austrian company has negative equity, an expert opinion on the going concern of such target company needs to be provided. Otherwise, the company needs to claim bankruptcy protection within 60 days.

Such issues may generally be resolved by way of new equity injections. Although not advisable, under certain limited circumstances it may also be possible to successfully complete a private equity transaction where the target fulfils the criteria of a reorganisation under the URG for a certain limited time period, provided an expert opinion is issued that in such particular case no reorganisation within the meaning of the URG has to be performed.

10 What types of debt are used to finance going-private/private equity transactions? Do margin loan restrictions have an impact on the debt financing of going-private/private equity transactions?

Financing may either be provided by way of equity, debt or mezzanine capital. Equity financing can be achieved by an increase of share capital pursuant to an equity injection in cash or in kind, the transformation of profit reserves or a merger. Depending on the agreed structure, the venture capital investor either acquires shares from existing shareholders with the obligation to contribute all or part of the purchase price into the target, or the

investor directly subscribes a capital increase of target.

Debt financing can comprise traditional bank loans on a revolving basis, corporate bonds, commercial papers or (un)secured notes.

Another frequently used tool for providing financing in the course of private equity transactions relates to mezzanine capital. Such innovative form of financing may either be provided by straight subordinated debt or other debt obligations containing an equity kicker. Typical equity-related debt obligations include convertible bonds, profit-participating loans and other profit-participating instruments. Further, silent partnership structures are used in order to provide mezzanine financing.

- 11** What are the key provisions in shareholder agreements covering minority investments or investments made by two or more private equity firms?

Shareholders' agreements regularly contain provisions on the following:

- corporate governance (nomination rights);
- information rights;
- provisions on call-on-capital (equity injections);
- coordination of voting rights;
- catalogue of actions requiring shareholders consent;
- non-competition provisions;
- confidentiality provisions;
- transfer restriction provisions (right of first refusal, pre-emptive rights, tag-along, drag-along, competitive sales process);
- exit provisions (trade sale, initial public offering);
- termination provisions.

In particular, corporate governance provisions have to be drafted carefully since Austrian stock corporation law provides for an independent board system. Therefore, syndicate resolutions cannot be implemented in the boards without specific legal mechanics.

- 12** Do private equity transactions involving leverage raise fraudulent conveyance issues?

Secured creditors have priority in the settlement of their claims with respect to the assets in which they hold a security right. Fraudulent conveyance issues mostly arise in case of bankruptcy. In such case, the assets will be sold and any proceeds remaining after settlement of the secured creditors' claims will become part of the general bankrupt's estate to be distributed among the creditors. As a general rule, no security interests will be recognised that were perfected within 60 days preceding the date of the opening of the bankruptcy proceedings. The purpose of such provision is clearly to avoid preferential treatment of certain creditors at a time when a bankruptcy is imminent.

The law also provides for the possibility of having certain transactions undertaken by the debtor during specified periods of time preceding the bankruptcy declared null and void. This occurs when it can be established that such transactions were undertaken with the intention of depriving other creditors of assets to which they would otherwise have been entitled for the settlement of their claims or to grant an unfair advantage to certain creditors. As stated above, transactions undertaken and securities perfected within 60 days prior to the opening of bankruptcy proceedings are as a general rule always voidable. Actions beyond this time may be voidable depending on various circumstances, eg financial status at the time when the action was consummated (reasonableness of the consideration). In addition, certain transactions undertaken with the intention of depriving other creditors of assets may also constitute a criminal offence.

- 13** What type of companies/industries have typically been the targets of going-private transactions? Has there been any change in focus in recent years?

In many cases, going-private transactions in the past have been the result of privatisation transactions. The Republic of Austria as former owner of such companies sold stakes into the capital market as a first privatisation step. Pursuant to the Austrian Takeover Act, the sale of the remaining stakes obligated the acquirer in many cases to launch a public takeover bid to all shareholders. Most of these mandatory takeover bids resulted in the acquirer obtaining more than 90 per cent of the share capital of the respective targets, enabling the acquirer to undertake a squeeze-out of the minority shareholders as described above. Pursuant to such squeeze-out, the Vienna Stock Exchange ex officio delisted the respective target company.

The most prominent going-private transactions concerned Austria Tabak AG in a takeover by the Gallaher Group, Voith AG in a takeover of Voith Austria Holding AG, Jenbacher AG in a takeover by General Electric, Topcall International AG in a takeover by the Dicom Group, and BBAG and BRAU UNION AG in a takeover by Heineken.

- 14** Do private equity firms have limitations on the size of transactions they may engage in?

Most Austrian private equity firms are structured as *Mittelstandsfinanzierungsgesellschaft* (MFAG). MFAGs are corporations and not treated as transparent for tax purposes under Austrian law. It needs to be considered that MFAGs are subject to strict investment limitations in order to be eligible for certain tax benefits, which include an exemption from capital duty and other charges as well as certain exemptions from capital gains and from withholding tax on dividend distributions up to an amount of €25,000.

The limitations stated in the law include, inter alia, that only certain types of instruments may be acquired by a MFAG and that 75 per cent of the funds available need to be domestically invested. Further, the majority of the funds need to be invested in Austrian SMEs which are predominantly engaged in an Austrian business. Moreover, investments in one single company are limited and any participation held by the MFAG may not exceed 49 per cent and may not result in a controlling interest.

Further, both pension funds and insurance companies may generally invest in private equity. However, Austrian law provides for certain investment restrictions in this regard.

- 15** How do the exit strategies and investment horizons of private equity firms affect the structuring and negotiation of leveraged buyout transactions?

In principle, the structuring and negotiation of the leverage buyout transactions are heavily affected by structuring a tax-efficient exit for the private equity firms. Moreover, from an investment horizon perspective it needs to be considered that the business model needs to take into account the available financing sources, in particular any bank debt provided and the cash flow being available in order to service such debt. The deductibility of interest for tax purposes is of course an important factor in any merger model underlying the private equity investment (tax shield).

Depending on the tax position of the selling entity, the structuring needs to achieve that only one level of tax is assessed in case of an exit and that any tax resulting from gain being recognised is optimised to the extent possible. For such purpose it is often advisable to prepare the target company by way of corporate reorganisation in order to structure the exit as efficiently as possible.

16 What are some of the principal accounting considerations for private equity transactions?

From 2005, Austrian publicly traded companies need to apply the International Financial Reporting Standards as the accounting principles being applicable by law for the consolidated financial statements. Otherwise, Austrian companies need to apply, in general, Austria's generally accepted accounting principles (GAAP), which are based on the principle of conservatism. Certain exceptions exist with regard to consolidated financial statements in case internationally recognised accounting standards are applied. In principle, under Austrian GAAP participations acquired are valued at cost. No goodwill depreciation arises in case of a share deal at the level of the acquiring entity. This may not be true for the consolidated financial statements.

Other accounting considerations include the proper accounting for mezzanine capital. In this regard, the Austrian Expert Committee of the Chamber of Accountants and Auditors has issued a detailed opinion on the requirements to be fulfilled in order to treat mezzanine capital as equity for accounting purposes.

Certainly, the correct treatment of interest expenses in accordance with the arm's-length standard – thereby considering any potential timing differences (eg deferred taxes) – needs to be considered.

17 What are the private industry pension plan (ERISA – the US Employee Retirement Income Security Act) asset issues with regard to investing in venture capital operating companies that arise in private equity transactions?

The Austrian Pension Fund Act (*Pensionskassengesetz*) contains detailed provisions on the legally valid investment portfolio of a pension fund. According to Section 25 of the Act, a pension fund may, inter alia, invest into shares as well as securities on participation capital and warrants.

Any investment in such shares and securities is, inter alia, subject to the securities being listed on an Austrian Stock Exchange or on a comparable stock exchange in a member state of the OECD. Besides other limitations, pension funds may not invest

more than 50 per cent into such shares and securities. Such figure is even lowered to 30 per cent if the shares or securities are denominated in a non-Austrian currency. An investment into shares or securities of one issuer may amount to 5 per cent of the total value of the respective pension fund's portfolio of the maximum. Moreover, a pension fund may not hold more than 5 per cent of the share capital of a stock corporation.

18 Do industry-specific regulatory schemes limit the potential targets of private equity firms?

As outlined above, various provisions of Austrian law limit the potential targets of private equity firms. Insurance companies, pension funds, MFAGs and others are subject to strict limitations in their investment portfolios. Moreover, Austrian law further restricts certain industries as to the ownership of private undertakings. For instance, according to a constitutional law, the Republic of Austria or the respective federal provinces have to own at least 51 per cent of the share capital of the respective energy providers regulated by federal or state law. Any transfer of shares in such energy providers exceeding 49 per cent of the share capital of the respective company therefore would be null and void.

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

Typical issues to be considered with regard to structuring and financing a cross-border transaction include the strict Austrian capital maintenance and financial assistance provisions. Under Austrian corporate law, a target company may only engage in arm's-length transactions with its shareholders or persons being related to a shareholder. Accordingly, in case an acquisition company incurs acquisition indebtedness, a target company may only secure such financing in case it receives an adequate premium complying with the arm's-length standard and in case the assumption of such risk is something a diligent manager would do

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without violating its duty of care. Since most of the equity transactions in Austria are heavily debt financed, it appears doubtful whether a diligent manager would accept the risk of providing security in such case even if he/she were to receive an adequate premium, which would be, in any event, a costly structure.

Accordingly, a security provided by the target company for acquisition indebtedness in general violates Austrian capital maintenance rules. Further, based on the Austrian Stock Corporation Act, even in case capital maintenance requirements would not be violated, the participation of the target company in any financing by way of providing security interests would violate the Austrian financial assistance rules. Contrary to the capital maintenance requirements, such violation would not render the transaction null and void, but would, however, result in potential liability of the management at a minimum.

20 What are the recent developments relating to going-private and private equity transactions in your jurisdiction?

Experts doubt whether a strong positive development of the venture capital sector will be seen within the next months. According to various surveys, venture capital investors will focus their investments in the sectors of nanotechnology, medical techniques, life science as well as security techniques/software. The media/entertainment sector, once said to be a future sector for venture capital interest, is now, however, less favourably regarded. In particular, venture capital investors seem unprepared to invest in companies which are active in the Internet, hardware and software sectors. It is further doubtful as to whether Austria will see in the next year transactions exceeding a transaction volume of €10 million. Transactions exceeding the said amount appear to be rare.