Austria

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

Generally, the entire range of private equity transactions commonly found in other jurisdictions is also available within Austria's legal framework. Although Austria's tax and legal environment was rated as being below average by the European Private Equity and Venture Capital Association (EVCA), the situation has now improved following the reduction, in 2005, of the corporate income tax rate from 34 per cent to 25 per cent.

Furthermore, companies specialising in the financing of small- and medium-sized enterprises (SMEs) (*Mittelstandsfinanzierungsgesellschaften* (MFAG)), which are often used by Austrian private equity firms, are to a certain extent subject to a favourable tax regime (see question 14). Accordingly, the Austrian venture capital market could be cautiously described as expanding following the first successful acquisitions of Austrian private equity firms. The development of the Vienna Stock Exchange (VSE) has continued to attract interest from international venture capital investors which have since proved to be active on the Austrian market. Austria is therefore seeing various kinds of venture capital investments, ranging from seed-financing to mature private equity investments.

Recent years have also seen international venture capital investors acquiring considerable stakes in Austrian companies, for example, 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 Corporate Governance Code (the Code). Amendments reflecting changes in the legal environment (eg, implementation of the Market Abuse Directive) have been incorporated in a revised 2005 version. 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 the principles set out in the OECD's Principles of Corporate Governance. It is also recommended, although not mandatory, that companies not listed on Austrian or foreign stock exchanges follow the Code. 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. They are monitored by an external institution on a regular and voluntary basis and its findings are reported to the public. The Code is neither a statute nor a decree. Adherence to the Code is voluntary. There are no legal consequences for non-adherence to the Code. However, nearly all stock corporations listed on the VSE have declared their compliance with the Code. Private companies, however, have not regularly adhered to the Code.

The most prominent regulations contained in the Code have been transformed into statutory law in the Austrian Company Law Amendment Act 2005. The rules on the supervisory board and its independence and transparency have been enhanced by the 2005 Act. To avoid conflicts of interest, members of the management board may only accept functions in the supervisory board of other companies after having obtained consent from the supervisory board. Further, 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 for 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.

In general, requirements under corporate governance rules as well as under, inter alia, mandatory capital markets legislation provide for a more stringent regime, including disclosure requirements as well as accounting rules and regulations, for public rather than for private companies.

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

Austrian law recognises both the 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* (AG)) are concerned, the Austrian Stock Corporation Act provides that a flexible compensation of management essentially has to result in participation in the annual profits of the respective company.

In any case, the supervisory board has to ensure that the aggregate compensation of management (ordinary compensation, incentive-based compensation and other payments) are in proportion to the functional tasks of the 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 has alleviated the rules on the share buy-back programmes for the back-up of management stock options.

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

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 to be eligible for or to 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 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 the detailed rules on content and pricing contained in the Austrian Takeover Act. The Austrian Takeover Act specifically sets out 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 and 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 approved by way of a shareholders' resolution.

Furthermore, the management board of a target company may be subject to a conflict of interest if 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. Pursuant to the principles of neutrality and transparency, the management members have to publicise their conflicts of interests and refrain from any further action facilitating a positive result of the takeover. 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, an ongoing private transaction of a publicly listed company may only be effected pursuant to a public takeover bid. Any bidder obtaining a controlling interest 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 10 weeks at the maximum. The Takeover Amendment Act 2006 entered into force on 20 May 2006, implementing the European Directive 2004/25/EC on takeover bids (Takeover Directive) and has amended, inter alia, the provisions concerning the offer price, whereby the minimum price to be offered in a mandatory offer or a voluntary offer aimed at the acquisition of a controlling interest must be higher than the highest price paid by the bidder during the 12 months preceding publication of the bid and the average share price during the six months immediately preceding the publication of the bid. In line with the Takeover Directive, the possibility of a 15 per cent reduction of the minimum price was eliminated by the Takeover Amendment Act 2006.

Austrian Stock Exchange law generally does not provide for the possibility of voluntary delisting. Therefore, a delisting of a company from the VSE has to be achieved through a corporate reorganisation by way of a squeeze-out of the remaining minority shareholders. In the course of the implementation of the Takeover Directive by the Takeover Amendment Act 2006, a new legal basis for the squeeze-out of minority shareholders has been enacted.

A 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. It could be performed until the Takeover Amendment Act 2006 went into effect, in principle, only by way of a disproportionate demerger of the minority shareholders or 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 safeguard procedures under corporate law to ensure minority shareholders are adequately compensated.

For both squeeze-out mechanisms described above, Austrian Corporate Law provides for enhanced disclosure requirements, in particular to protect the interests of the minority shareholders, the creditors and the works council. The introduction of the new Squeeze-out Act shall provide a unification of the several ways to exclude a minority shareholder. According to the new Squeeze-out Act, a majority shareholder holding not less than 90 per cent of the entire (voting and non-voting) share capital of the company may squeeze out the remaining shareholders at an equitable price. The squeeze-out right is general and is not limited to a preceding takeover bid. The minority shareholders are not entitled to block the squeeze-out but have the right of separate judicial review of the fairness of the compensation paid for their minority stake.

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 relate to the structuring of the investment itself, the distribution of dividends, the servicing of acquisition indebtedness and the tax-efficient exit of the shareholders.

When entering into an investment, it should be noted that Austria, in general, levies capital duty amounting to one per cent for any capital contribution made to an Austrian company, irrespective of whether such contribution is effected via an actual capital increase or otherwise.

Since 2005, interest expenses payable on debt incurred for the acquisition of shares are tax deductible. However, target

companies still have to distribute dividends to service the debt obligation of the acquiring parent company and dividends can generally only be distributed once during any accounting period (one intermediate dividend may, however, be payable in the 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 is true for any compensation paid to management regarding stock options and deferred compensation plans.

Other new developments which entered into force on 1 January 2005 include the possibility of goodwill depreciation in the 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 in the case of a share deal. This provision has been enacted to provide investors with a level playing field when making the decision whether to make an investment by way of an asset deal or by way of a share deal. This goal has not been quite reached because the Austrian legislator inserted certain restrictions 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. According to the new Squeeze-out Act, a condition precedent for the right of squeeze-out by a majority shareholder in connection with a takeover bid is, inter alia, that the offeror squeeze-out be completed within three months of the deadline for acceptance of the bid. Registration of the resolution by the majority shareholder is constitutive and, therefore, all shares of the minority shareholder shall pass to the majority shareholder upon registration of the resolution in the commercial register.

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

According to Austrian stock corporation law, the target company is prohibited from financing, or providing assistance in the financing, of the acquisition of its own shares. Such financing or assistance in 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 the unlawful repayment of equity under section 52 of the Austrian Stock Corporation Act (section 82 of the Austrian Act on Limited Liability Companies), resulting in the transaction being null and void.

In the course of loan-financed structures, banks and other lenders intend to have debts secured with assets of the target's group. Contrary to the pledging of shares, lenders may 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 the target to the financing bank without the target receiving adequate consideration and without the management of the target having undertaken a due risk assessment of such security, stands in conflict with the mandatory provisions of Austrian law.

The guarantees and representations and warranties to be declared by the seller depend on the respective deal structure. Precedents show that unencumbered ownership of the shares to be sold has to be guaranteed. In addition, ordinary guarantees and representations and warranties relating 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 are pursuant to the results of a due-diligence review.

The instrument of indemnification is normally adapted to the legal instruments provided by Austrian law. Acquisition agreements usually contain provisions on indemnifications being dependent on the seller's fault or the purchaser being under an obligation to prove the reduction in value of the respective business of the target company. 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 the case of the target's indebtedness, there are certain restrictions for the leveraging up of companies. 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 (*Unternehmensreorganisationsgesetz* (URG)) an Austrian company has to initiate a complex reorganisation procedure if the target company has less than 8 per cent equity or a deemed debt redemption period of more than 15 years. Further, in such cases certain liability issues may arise for the management. Moreover, if an Austrian company has negative equity, an expert opinion needs to be provided. Otherwise, the company needs to claim bankruptcy protection within 60 days.

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

10 What types of debt are used to finance going-private or private equity transactions? Do margin loan restrictions have an impact on the debt financing of these 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 providing for 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 the target.

Debt financing can comprise traditional bank loans on a revolving basis, corporate bonds, commercial papers or secured and unsecured 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 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 mechanisms.

12 Do private equity transactions involving leverage raise 'fraudulent conveyance' issues? How are these issues typically handled in a going-private transaction?

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 cases of bankruptcy. In such a 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 perfected within 60 days preceding the date of the opening of the bankruptcy proceedings will be recognised. 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 the various circumstances, for example, 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 types of companies or 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 forced 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 VSE 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, BBAG and BRAU UNION AG in a takeover by Heineken, VA Tech in a takeover by Siemens, Investkredit Bank AG in a takeover by Österreichische Volksbanken AG and Bank Austria Creditanstalt AG in a takeover by UniCredito Italiano SpA (the latter as a result of the takeover of German HypoVereinsbank by UniCredito).

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

Most Austrian private equity firms are structured as MFAGs. MFAGs are corporations and not treated as transparent for tax purposes under Austrian law. MFAGs are subject to strict investment limitations 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 an 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 LBO transactions are heavily affected by structuring a tax-efficient exit for the private equity firms. Moreover, from an investment horizon perspective the business model needs to take into account the available financing sources, in particular any bank debt provided and the cash flow available 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 only one level of tax being assessed in the case of an exit. Any tax resulting from a gain being recognised has to be optimised to the extent possible. To structure the exit as efficiently as possible it is advisable to carry out a corporate reorganisation.

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 applicable by law for the consolidated financial statements. Otherwise, Austrian companies need to apply 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 the case internationally recognised accounting standards are applied. In principle, under Austrian GAAP participations acquired are valued at cost. No goodwill depreciation arises in the 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 to treat mezzanine capital as equity for accounting purposes.

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 provisions relating to debt and equity financing are typically found in a going-private transaction? What other documents set out the expected financing?

As already outlined above, inter alia, the provisions of the Austrian Takeover Act and the Austrian Code of Corporate Governance are usually relevant with respect to going-private transactions. Furthermore, the prohibition of repayment of capital may be considerable. Section 52 of the Austrian Stock Corporation Act states for stock corporations that contributions may not be repaid to the shareholders and, for the lifetime of the company, shareholders shall only be entitled to any balance sheet profit, resulting from the annual balance sheet, to the extent that such profit is not excluded from distribution by law or the company statutes.

Long preliminary negotiations are not unusual in such transactions. As a rule, such negotiations result in the execution of preliminary agreements, for example a letter of intent providing for break-up fees. Break-up fees are arising more frequently in such deals and are an arrangement whereby the acquirer agrees to pay a fee to the seller if the deal does not go through.

Update and trends

Experts acknowledge the positive development of the private equity sector in Austria. However, banks are still the first port of call for companies requiring additional capital. According to various surveys, venture capital investors will continue to focus their investments in the sectors of nanotechnology, medical techniques, life science as well as security techniques and software. An increase in the expansion and start-up phases is also expected.

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. 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 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, if an acquisition company incurs acquisition indebtedness, a target company may only secure such financing if it receives an adequate premium complying with the arm's length standard and if the assumption of such risk is something a diligent manager would do without violating his or her duty. 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 a case even if he or she were to receive an adequate premium, which would, in any event, be 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 cases where 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 it would result, at a minimum, in the potential liability of the management.

20 What are the special considerations when more than one private equity firm is participating in a club or group deal?

There are no special considerations as to club or group deals as a matter of Austrian mandatory law. However, two or more investors participating in one and the same transaction will generally tend to regulate their relationship in a shareholders' agreement (see question 11).