The Acquisition and Leveraged Finance Review

Sixth Edition

Editor
Marc Hanrahan

The Law Reviews

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PREFACE

Leveraged finance, particularly with respect to acquisition financing, has been an expanding asset class for many years. As of the fourth to quarter of 2018, leveraged loans outstanding totalled US$1,147 billion and high-yield bonds outstanding totalled US$1,256 billion. The average annual growth rate for leveraged loans outstanding (2000–2018) equalled 15.8 per cent and for high-yield bonds (1997–2018) equalled 6.5 per cent.[1] In 2018, leveraged finance loan totals for acquisition finance surpassed the previous records set in 2007.[2]

The leveraged finance markets and these markets' participants grow deeper and more sophisticated year over year. The playing field for acquisition finance, particularly for private equity deals, remains in large part an issuer-controlled game with an increasing number of new financing sources clamouring to become involved. As has been noted by many, credit controls (covenants and collateral coverage) remain soft and continue to weaken in some cases. That said, default rates are at the low end of the historical range and new piles of capital continue to be accumulated to support acquisition financing. As discussed in the Introduction that follows, regulators are indicating concern about the leveraged loan market in the case of an economic downturn but, to date, that does not seem to have stifled the appetite for new deals and associated financings.

For lawyers, this is a great area of practice. There is lots of activity given the size of the asset class; everything from new issuance, to refinancings, to work outs and insolvency proceedings. But to be an effective practitioner in the area, more is required than occasionally dabbling in leveraged finance transactions. Most lawyers who successfully practice in leveraged finance do it full time. Knowing 'market terms' is considered to be very helpful, if not critical, to success in this area.

This volume is intended to introduce the newcomer to the legal basics involved in leveraged finance, particularly acquisition finance, so that he or she is grounded in the underpinnings of the practice area. It is also intended to be a helpful update for the more seasoned practitioner with respect to what is new and what is being talked about in leveraged finance deals.

1 Source: Financial Stability Report of the Board of Governors of the Federal Reserve System, May 2019.

2 2018: U.S. Primary Loan Market Review, LSTA 3 January 2018.

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Marc Hanrahan
Milbank LLP
New York, NY
September 2019

Chapter 4

AUSTRIA

Markus Fellner and Florian Kranebitter[1]

I OVERVIEW

The acquisition and leveraged finance market in Austria still benefits from stable transaction activity. According to publicly available data, though the overall transaction volume in Austria declined by 12 per cent to approximately €4.5 billion in the first half of 2019, this decline was comparatively small compared to other M&A markets.

The overwhelming majority of transactions were again strategic transactions. Transactions by financial investors (private equity or venture capital) fell in the first half of 2019. Hence, private venture capital continues to play only a minor role in the Austrian transaction market.

The largest deal of the year to date with Austrian participation took place in the oil sector: OMV invested around €2.2 billion acquiring 15 per cent of a refinery hub with integrated petrochemicals of the Abu Dhabi Oil Refining Company. This was followed by the complete takeover of Galeria Karstadt Kaufhof by the Signa Group for around €900 million, with the closing of the transaction subject to approval by the competition authorities. Fellner Wratzfeld & Partners assisted with the €600 million acquisition of Kika/Leiner by the Signa Group in the course of the Steinhoff group restructuring. This transaction was a landmark transaction in terms of timing and involved the securing of thousands of jobs.

To pursue their growth Austrian investors increasingly focus on acquisitions outside Austria, with around €3.6 billion being invested. Germany continues to be the most attractive investment target for Austrian investors (and vice versa). The largest part of outbound investments is still made in Europe (the Americas with only 6 per cent, Australia with 4.5 per cent and the Middle East with 3 per cent are far off). Takeovers by German companies account for more than 30 per cent of all inbound transactions, followed by transactions from France, the US, Finland and Belgium.

From a market perspective, supply and demand regarding loan financing has been growing for years. However, lending companies, in particular credit institutions, are still in the process of implementing and complying with European (and Austrian) regulatory legislation (e.g., increased equity requirements and capital buffers depending on the particular credit institution's profile).

Overall lending activity is dominated by the participation in Anglo-Saxon and German syndicated financing transactions. Deal activity in the Austrian law financing market seems to be growing, while deal volumes remain stable or below pre-crisis levels. Massive growth can

1 Markus Fellner and Florian Kranebitter are partners at Fellner Wratzfeld & Partners.

be seen in deals involving low two-digit-million volumes focusing on mid-market companies. Moreover low interest rates have created a borrower-friendly environment; borrowers are seeking to refinance their existing debt on more favourable and commercially attractive terms.

II REGULATORY AND TAX MATTERS

i Licensing

In order to provide loan financing on a commercial level to companies in Austria, there are three possible options:

a application for a banking licence: Obtaining a banking licence is a rather complicated procedure and demands in-depth preparation over a longer period of time. One of the legal requirements that has to be satisfied and is especially extensive is the creation of an appropriate business plan that is subject to review by the regulator;

b it is legally possible for a credit institute of another EU Member State to establish a branch (the existing banking licence would need to be notified to the Austrian regulator); and

c the most common approach for non-Austrian banks that want to become active in the lending business and wish to avoid establishing a permanent presence is utilising the EU freedom of service to render services in another EU Member State.

For non-banks it is possible to participate in the lending business only if this activity is exempted from the requirement to hold a banking licence (e.g., acquisition of loan portfolios by special securitisation purpose entities). According to Section 4(1) of the Austrian Banking Act, the banking licence has to be issued by the Austrian regulator (the Financial Market Authority) for lending business (i.e., the providing of financing to borrowers on a commercial basis). Notified licences of a credit institution domiciled in another European Economic Area (EEA) jurisdiction (based on the home Member State concept) will be held equivalent for this purpose.

The same applies for the acquisition of (loan) receivables on a commercial basis (i.e., factoring), which, in principle, prevents workaround structures, such as the disbursement of a loan by an Austrian 'fronting bank' and immediate acquisition of the loan by a foreign, non-licensed lender. Limited exceptions to this principle apply, inter alia, to insurance companies granting loans for the purpose of creating a reserved asset base regarding their insured persons or customers.

Crowdfunding has recently been regulated in statutory law and provides for exceptions from both the bank licence and capital markets prospectus requirements, if and to the extent that a financing does not exceed certain thresholds. On the other hand, blockchain technologies in financing seem to be gaining tremendous attraction but remain so far unregulated. The Austrian regulator, however – as is the case with the German BaFin – is in the course of discussing the setting up of regulations.

ii Taxes and duties

Generally, not subject to withholding tax are the repayments of principal amounts under loan transactions. Additionally, as a general rule, interest payments are not subject to withholding tax. Rather, these payments are taken into account for purposes of the (corporate) income tax of the lender.

There are numerous double taxation treaties in place between Austria and a large number of jurisdictions, which typically provide for withholding tax to be considered as a deductible or capable of being refunded, or both. If payment of interest is effected, however, to a non-Austrian lender then withholding tax in the amount of 35 per cent may apply.

A significant potential tax burden or risk has been removed from granting loans to Austrian borrowers because of the abolition of Austrian stamp duty on loans and credits, effective for loans and credits granted on or after 1 January 2011. Certain types of security arrangements (such as suretyships and assignments) would also be subject to stamp duty. There is an exception, however, for these transactions entered into for the purpose of securing loan obligations (which are, themselves, exempt from stamp duty).

Debt funding may be subject to Austrian stamp duty (applied at a rate of 0.8 per cent to be calculated on the basis of the consideration for the acquisition of the loan) if it is structured by way of the acquisition of loan receivables (on a commercial basis). Numerous workaround structures are available (such as offshore documentation, i.e., execution and permanent safekeeping of transaction documentation, certified copies, etc., outside of Austria and strict avoidance of creating 'substitute documentation') in those cases (which would not apply to the original provision of debt financing by way of disbursing a loan).

In February 2019, updated guidelines regarding the Austrian Stamp Duty Act were published in the interest of uniform procedure and interpretation. Over the past 10 years, there were numerous changes to the law, which led to uncertainty in many areas. The guidelines have been revised, with all provisions which were no longer valid being deleted and new legal provisions being incorporated. The significant changes related to the comprehensive exemption of stamp duty for publications and certificates drawn up and issued on the basis of the Austrian Trade Regulations as well as entries relating to the drawing up and issuing of documents on the basis of the Austrian Stamp Duty Act. In addition, due to precedents set down by the Administrative Court and the Federal Fiscal Court, the assessment of options has been amended.

Interest charged to customers (borrowers) is not subject to regulatory limitations. However, there are certain basic limitations under Austrian civil law. Usury and potentially criminal law sanctions (for instance, fraud) are prohibited. There is a requirement, however, that the interest (agreements) may only then be considered prohibited and unenforceable if and to the extent that the agreed interest rate is clearly disproportionate to market terms and conditions and an agreement to that effect could only be reached (on record) because of the weakness, predicament or inexperience of the borrower. In the retail segment (consumer loans), various information duties and formal requirements apply. In commercial lending, relevant examples are hardly existent or relevant.

III SECURITY AND GUARANTEES

i General

In Austria, there are two general groups of collateral that may be used to secure lending obligations: personal collateral and *in rem* collateral. The following types of personal collateral for securing lending obligations are the most common: (1) assumption of debt; (2) sureties; (3) guarantees; and (4) letters of comfort.

Most common types of *in rem* collateral are: (1) pledge of assets (such as a pledge on movables or a mortgage); (2) transfer of title for security purposes; (3) assignment for security purposes; and (4) retention of title.

The most common types of collateral in lending transactions are share pledges, mortgages, account pledges, assignment of current and future receivables, trademark and IP right pledges, and sometimes the pledge of stock in warehouses (which, based on the very stringent law on perfection, basically requires that the pledgee takes control over the stock, hence making it extremely difficult to establish and maintain under Austrian law).

ii Limitations

Downstream guarantees (or other security) are not restricted by Austrian law. Stringent limitations apply, however, to upstream and side-stream guarantees provided by corporations (and equivalent entities).

In principle, distributions to (direct or indirect) shareholders of a corporation (AG, GmbH, GmbH & Co KG, i.e., a limited partnership in which the only unlimited partner is a GmbH) may only be effected under specific circumstances, namely (1) in the form of formal dividend distributions based on a shareholders' resolution; (2) in the case of a capital decrease (which also requires a shareholders' resolution); or (3) in the form of a distribution of liquidation surplus. In addition, it is recognised that a company and its shareholders may enter into transactions with each other on arm's-length terms and conditions. This requirement entails that the management of the company makes – prior to entering into such a transaction – a comprehensive assessment of a proposed transaction, in particular of the risks involved, and shall only enter into such transactions with its (direct or indirect shareholder or a sister company) if and to the extent that it would enter into the transaction on identical terms and conditions with an unrelated third party. However, the management must not enter into a transaction, if by any such transaction the existence of the company would be threatened.

To some extent, Austrian case law also accepts specific corporate benefits as an adequate means of justification for granting upstream and side-stream guarantees. This corporate benefit cannot be disproportionate to the risk and must be specific and not only a general corporate benefit, such as a general 'group benefit'. Austrian case law on these restrictions is based on a case-by-case evaluation and has become increasingly stringent over the past two decades. In practice, it is advisable to have the management of the company assess the proposed transaction in accordance with the above criteria.

Also, the Austrian courts impose very strict criteria on the permissibility of loans of a company to its shareholders and affiliated companies within the framework of the Austrian capital maintenance rules. Recently, the Austrian Supreme Court ruled that the classic third party comparison for transactions is not a suitable criterion for transactions of clearing companies, whose role is the financing and the forwarding of financial resources within the group. This is due to the fact that non-affiliated companies are not allowed to conclude these transactions. The courts considered which yardstick could be applied to measure these transactions of clearing companies. The court held that even though the clearing companies functioned in many ways like a bank, a comparison was not possible, because banks have different risk structures. Instead, the court applied the yardstick of a prudent businessman in determining whether the lending is lawful. Also the business purposes of the company and its corporate purpose help to determine the duty of care in determining whether the loans were justifiable. Potential consequences of breach of these Austrian capital maintenance rules include personal liability, potential criminal liability of the management as well as nullity of the respective transaction.

iii Roles of an agent or trustee

Under Austrian law accessory collateral such as sureties or pledges, will cease if it becomes separated from the underlying secured obligation. The concept of 'security trustees' or 'agents', as well as a generic type of 'parallel debt' is not recognised to validly establish collateral for one 'security agent', which is not at the same time a lender or not a lender in respect of all obligations that shall be secured by the (accessory) collateral. Austrian market practice in order to ensure that the characteristic 'accessory' is fulfilled either provides that all secured parties are at the same time pledgees (or direct beneficiaries) under the security agreements or that a 'security agent' is appointed, whereby it is agreed among all lenders with the consent of the borrower (or other obligors) that the security agent is the joint and several creditor of all claims, with it being further agreed among all creditors that only the security agent shall (following a decision process among all lenders) have the right to enforce the collateral and will then distribute the proceeds from this enforcement amongst all lenders in proportion to their exposure under the secured obligations.

As regards validity of non-accessory collateral (e.g., guarantees), it is not required that they are directly connected with the secured obligation. It is market practice to provide for joint and several creditorship if the lenders desire to execute their rights arising from the collateral via one security agent because loan documentation typically includes accessory and non-accessory collateral.

iv Collateral security over real property

Real property can be a security in the form of a pledge (mortgage). The pledge must be agreed upon between the pledgor and the pledgee. Though the pledge agreement does not require a specific form, for perfection it needs to be registered in the land register where the real property that is being pledged is located. In order to accomplish the entry into the land register, the pledgor of the property must provide a specific consent declaration in authenticated form regarding the registration. Multiple pledges over one individual property are possible. These will be ranked towards each other in terms of priority (the point in time when the application for registration of the pledge in the land register reaches the competent land register is decisive). It is possible to establish a mortgage over more than one property by creating a simultaneous mortgage.[2]

Registration fees amount to 1.2 per cent of the secured amount of the real property. That is why they play a significant role in the registration of a pledge over real property in the land register. In some lending scenarios, it is possible to avoid these fees. In these instances, the lender agrees to receive a registrable (i.e., authenticated) pledge agreement in combination with a ranking, which ensures for one year that no third party may enter another mortgage into the specific rank (which, however, owing to the limited time of the ranking order, the 0.6 per cent fee of the secured amount associated with the entry of the ranking order and the fact that the critical period of rescission under insolvency law will only start to run if the mortgage is registered, is not ideal in most lending scenarios).

Generally, any fixtures and accessories are covered by the pledge. Equipment that is not connected to real property is considered to be movable property. With regard to security agreements in respect to movables, no specific formal requirements must be met. However, Austrian law imposes strict standards of perfection that either require a physical transfer of

2 *Simultanhypothek*.

the pledged goods or any equivalent measure (such as handing over via declaration) in the event the physical transfer is too burdensome to be performed. The same strict perfection requirements are required in the event of the full title transfer of such goods for security purposes (in order to avoid circumvention).

IV PRIORITY OF CLAIMS

An opening of formal court insolvency proceedings automatically leads to a stay against all actions of unsecured creditors. However, secured creditors are usually not affected by the opening of insolvency proceedings. There are three types of proceedings provided for in the Insolvency Act (reorganisation proceedings with or without debtor in possession and liquidation proceedings). Claims are classified and ranked in the following order or priority.

Secured creditors either have claims of separation to receive assets or claims of separation, or both, to receive the proceeds of enforcement after sale. Except for a possible voidance claim, neither of these claims are affected by the opening of insolvency proceedings. The secured creditor merely has to inform the administrator and, lacking acknowledgement of the claim, potentially file a lawsuit against the insolvency administrator in order to enforce the senior security. If these claims could jeopardise the business continuity of the debtor, there is a possibility that no secured claim may be paid within six months of the opening of insolvency proceedings. The provision may only be disregarded if the enforcement is vital to prevent severe economic disadvantages for the secured creditor.

Estate claims are to be satisfied next and, therefore, prior to the other insolvency claims. They encompass, inter alia, the costs of the insolvency proceedings, the expenses of the management and administration of the estate, claims for labour, services and goods furnished to the estate post-filing and the costs for the insolvency administrator. Preferential creditors of estate claims share in such claims on a pro rata basis.

Insolvency claims are claims by unsecured creditors and ranked next. They may be filed with the competent court within a time period fixed by the court after the opening of insolvency proceedings. Those insolvency creditors who file claims that were not contested by the insolvency administrator also share in such claims on a pro rata basis.

Subordinate claims may result from contractual provisions or from statutory provisions. In general, subordinate creditors only participate in the insolvency proceedings if a surplus for distribution is generated. Regarding foreign creditors, no special procedures apply. Prior to the opening of insolvency proceedings, unsecured creditors can enforce a claim pursuant to the Austrian Enforcement Act.

V JURISDICTION

i Choice of law

In general, the choice of a foreign law as the governing law for a contract is permitted, even if the contract is to be enforced in Austria; in terms of market practice this might apply to (English or German law-governed) loan agreements. However, regarding the granting and perfection of security rights there are restrictions, which depending on the type of security are in most instances governed by local (Austrian) law. This would apply among others to pledges over the shares in Austrian companies, pledges over or security assignments of Austrian law governed receivables and the creation of pledges or mortgages over Austrian real properties. Therefore, it is common market practice that security rights over assets located in Austria or provided by Austrian domiciled transferors or pledgers are documented in Austrian law-governed security documentation.

ii Enforcement

Regarding the enforcement of judgments or awards that were not rendered in Austria, the following options are possible.

Court judgments of EU Member States

The enforcement of judgments rendered in another EU Member State is governed by Regulation (EC) No. 1215/2012 on the Jurisdiction and Recognition and Enforcement of Judgments in Civil and Commercial Matters (Brussels Ia Regulation). In Austria the Brussels Ia Regulation is applicable. Therefore, judgments from other EU Member States are recognised without any special procedure being required or any re-examination of the merits of the case (exceptions may apply, mainly with respect to Austrian *ordre public*).

Court judgments of non-EU Member States

Beyond the applicability of the Brussels Ia Regulation, enforceability of foreign judgments is conditional and depends on whether there is a bilateral treaty between Austria and the home state of the other party. A fundamental criterion is reciprocity, which is to be ensured under bilateral treaties or regulations. Additionally, it is required that Austrian law would not have denied the foreign court, having rendered the relevant decision, if the defendant in the enforcement proceedings has been duly convoked in the original proceedings before the foreign court and if the relevant judgment is final in the sense that it may no longer be challenged before the courts and authorities of the foreign state. In the event the counterparty had not had the opportunity to participate in the foreign court proceedings, the enforcement of the court judgment may be denied. A similar result applies if the enforcement is aimed at an action that may not be enforced or that is not allowed under Austrian law, or if the Austrian *ordre public* would be violated.

Arbitral awards

Austria is a contracting state of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Arbitral proceedings and the enforcement of arbitral awards are common in Austria.

VI ACQUISITIONS OF PUBLIC COMPANIES

i Regulatory legislation

The Takeover Act 1999, amended by the Takeover Act Amendment Act 2006 and most recently by the new delisting rules of 2018, regulates public bids on the primary and secondary market. It is applicable to listed Austrian companies and focuses on regulating voluntary public takeover bids while setting out the conditions that trigger compulsory takeover bids. The Takeover Act is not applicable to non-public bids and bids for shares that are not listed on a stock exchange. However, if in the course of a non-public bid a person obtains a controlling interest in an offeree company, such person will then be subject to the rules on mandatory public bids of the Takeover Act. Furthermore it is relevant regarding cross-border takeover transactions. In case a public company is incorporated in Austria but the shares are not admitted to trading in Austria but on a regulated market of another member state of the EU, takeover bids are only subject to a number of basic provisions of the Takeover Act 1999, including, inter alia, the provisions regarding mandatory public bids.

The conditions for a public takeover are contained in the Takeover Act. Accordingly, the bidder must communicate its intention to acquire a stake in a public company without delay if there are speculations which could later alter the price of the stock. The bidder also has to inform the target´s representatives immediately, notifying them that the executive and supervisory boards have envisaged placing an offer, or circumstances compel them to place such offer. Additionally, the workers council must be notified and a financial expert must be included in the public takeover process.

The delisting rules were introduced to incorporate new EU investor protection and capital market transparency regulations. In principle, a delisting should be possible if it does not endanger the interest of investors. There needs to be a positive resolution of the annual general meeting based on a qualified majority, with an official listing over a period of three years. Also a 'cold delisting' under company law such as mergers were also introduced. A merger of a listed company with a non-listed company may only be filed for registration after an offer pursuant to the fifth section of the Takeover Act has been published with reference to the planned merger within the last six months prior to filing or with reference to the merger resolutions passed. Such a delisting could be based on economic factors or internal company initiatives to avoid transparency rules and competitive disadvantages associated with the stock exchange regulation.

Since December 2007, takeovers by cross-border mergers have been permitted. The legal framework for these takeovers is provided by the EU Merger Act. In this context, the Squeeze-Out Act opens up the possibility of squeezing-out minority shareholders (up to 10 per cent of the remaining shareholders) in both listed and unlisted companies.

The Foreign Trade Act can be of great importance to foreign investors when acquiring shares of 25 per cent or more in an Austrian company involved in specific protected industry sectors, such as defence equipment, energy, water supply, traffic, education and telecoms. The acquisition then requires advance approval from the Austrian Ministry of Economic Affairs.

The General Data Protection Regulation has introduced many changes to the existing rules on data protection in Austria. These changes relate to the simplification and deletion of personal data, which are processed via automated means. Also, the regulations on the permissibility of the processing of personal data concerning criminal acts have been amended. The role of the data protection officer has been clarified regarding the right to maintain secrecy and the right to refuse to give evidence. Also the sanctions regarding the penal provisions for violations of the provisions of the Data Protection Act have been modified. The new regulation no longer provides for notifications to the data processing registry. This has been replaced with an individual obligation to evaluate data processing operations. Additionally, the data protection authority may also establish and publish a list of processing operations for which a data protection impact assessment is not required.

ii Public offers

Public offers are the most common way to obtain control of a public company, whether they are voluntary or mandatory, or a voluntary bid aimed at control. Avoiding the application of the Takeover Act to public offers is possible in certain cases despite the change of control in the Austrian target, particularly if they are structured as cross-border reverse takeovers.

iii Hostile bids

Hostile bids are permitted. However, they are not as common as in some other jurisdictions due to the two-tier board structure of Austrian AGs; an AG listed on the stock exchange must have a management board and a supervisory board and publicly held shares (free float).

VII THE YEAR IN REVIEW

Though the value of M&A with target companies in Austria declined slightly in 2019, the M&A market remains stable. This downturn, however, is in line with the European trend. Factors such as global trade conflicts between the US and China and the ongoing Brexit discussions continue to cause uncertainty among investors. The most noteworthy transaction was OMV's investment of €2.2 billion with the Abu Dhabi Oil Refining Company. Also worthy of mention was the sale by Steinhoff of Kika/Leiner to the Signa Group. This landmark transaction helped secure thousands of jobs. A significant change in legislation that has affected public M&A transactions was the introduction of new delisting rules for the Austrian Stock Exchange Act, which incorporated new EU investor protection and capital market transparency regulations. Also, due diligence processes in M&A transactions (and including finance due diligence) have been significantly impacted by changes in the Data Protection Act, with new sanctions and fines being introduced for violations of the provisions of the Act.

VIII OUTLOOK

We expect that Austria will remain an active and stable jurisdiction for acquisition and leveraged finance. Though Austria is a relatively small market, Austrian companies have a strong reputation worldwide for having excellent expertise especially in the high-end technology area. Another reason for optimism is the strong economic position of Austria generally, which is also firmly embedded in the EU. Persistently low interest rates and the existing high liquidity in the market will also continue to push the transaction market. We also expect technologically advanced Austrian companies to continue to make strides, all within a very stable economic environment in Austria.

Appendix 1

ABOUT THE AUTHORS

MARKUS FELLNER

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Markus Fellner is a founding partner who specialises in banking and finance, corporate and M&A, insolvency law and restructuring, and dispute resolution. He was admitted to the Austrian Bar in 1988 and lectures at various institutions, having been awarded a *mag iur* from the University of Vienna and a social and economic sciences degree from the Vienna University of Economics and Business.

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